Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1327

THE BOEING COMPANY

(formerly The Boeing Airplane Company), *et al.*,

Petitioners,

v.

WILLIAM R. VAN GEMERT, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TABLE OF CONTENTS

	PAGE
Opinions Below	2
Jurisdiction	2
Statutes Involved	2
Question Presented	4
Statement of the Case	4
Reasons for Granting the Writ	7
POINT I—The Decision of the Court of Appeals Is Contrary to This Court's Decision in *Alyeska Pipeline Service Co.* v. *Wilderness Society*	9
POINT II—The Decision of the Court of Appeals Will Significantly Affect the Conduct of Class Action Litigation by Allowing Class Action Attorneys to Collect Fees Which Are Disproportionate to the Benefits Actually Conferred	12
CONCLUSION	15
APPENDIX A	1a
APPENDIX B	27a
APPENDIX C	37a
APPENDIX D	49a
APPENDIX E	53a

PAGE

TABLE OF AUTHORITIES

Cases

Alyeska Pipeline Service Co. v. *Wilderness Society*, 421 U.S. 240 (1975) 1, 4, 6, 7, 9, 10, 11, 12, 15
American Timber & Trading Co. v. *First National Bank*, Civ. No. 70-687 (D. Oregon) 8
Central Railroad & Banking Co. v. *Pettus*, 113 U.S. 116 (1885) 9, 10
Coopers & Lybrand v. *Livesay*, 98 S.Ct. 2454 (1978) 8, 13
Decker v. *Fillis*, 306 F. Supp. 613 (D. Utah 1969) ... 13
Eisen v. *Carlisle & Jacquelin*, 479 F.2d 1005 (2d Cir. 1973), *vacated and remanded on other grounds*, 417 U.S. 156 (1974) 5, 10, 13
Eisen v. *Carlisle & Jacquelin*, 391 F.2d 555 (2d Cir. 1968) 8
Gardner v. *Westinghouse Broadcasting Co.*, 98 S.Ct. 2451 (1978) 8
In re Hotel Telephone Charges, 500 F.2d 86 (9th Cir. 1974) 14
Oppenheimer Fund, Inc. v. *Sanders*, 98 S.Ct. 2380 (1978) 8, 13
Sprague v. *Ticonic National Bank*, 307 U.S. 161 (1939) 11, 12
Trustees v. *Greenough*, 105 U.S. 527 (1882) 9–10, 12

Statutes & Rules

28 U.S.C. § 1254(1) 2
28 U.S.C. § 1920 ..... 2–3, 7
28 U.S.C. § 1923 ..... 3, 7
Federal Rules of Civil Procedure, Rule 23 13

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THE BOEING COMPANY

(formerly The Boeing Airplane Company), *et al.*,

Petitioners,

v.

WILLIAM R. VAN GEMERT, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment entered on December 21, 1978, by the United States Court of Appeals for the Second Circuit, sitting *en banc*, reversing the decision of a panel of that court, and affirming a judgment of the United States District Court for the Southern District of New York which, in class action litigation, vastly alters the American Rule on attorneys' fees defined by this Court in *Alyeska Pipeline Service Co.* v. *Wilderness Society*, 421 U.S. 240 (1975).

The Court of Appeals established, as a matter of federal law, that prevailing class action attorneys are to be paid attorneys' fees not only from money actually claimed by class members in the litigation, but also from money that belongs to others because it has not been claimed by the class.

Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit *en banc,* filed December 21, 1978 has not yet been officially reported and is set forth as Appendix A hereto. The opinion of the panel, reported at 573 F.2d 733 (2d Cir. 1978) (*"Van Gemert III"*) is set forth as Appendix B hereto. The orders of the District Court dated June 30 and September 22, 1977 which were affirmed by the Court of Appeals *en banc* are set forth as Appendix C hereto. The opinions of the Second Circuit on the previous appeals in this action are reported at 553 F.2d 812 (2d Cir. 1977) (*"Van Gemert II"*) set forth as Appendix D hereto, and 520 F.2d 1373 (2d Cir.), *cert. denied,* 423 U.S. 947 (1975) (*"Van Gemert I"*) set forth as Appendix E hereto. None of the other opinions of the District Court other than its opinion certifying the action as a class action, 259 F. Supp. 125 (S.D.N.Y. 1966), has ever been reported.

Jurisdiction

The judgment of the Court of Appeals *en banc* was entered on December 21, 1978. No petition for rehearing was filed. The mandate of the Court of Appeals was stayed by order dated February 23, 1979, pending filing of this petition for certiorari. The jurisdiction of this Court is based upon 28 U.S.C. § 1254(1).

Statutes Involved

62 Stat. 955, 28 U.S.C. § 1920 provides:

> A judge or clerk of any court of the United States may tax as costs the following:
>
> (1) Fees of the clerk and marshal;

> (2) Fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case;
>
> (3) Fees and disbursements for printing and witnesses;
>
> (4) Fees for exemplification and copies of papers necessarily obtained for use in the case;
>
> (5) Docket fees under section 1923 of this title.
>
> A bill of costs shall be filed in the case and, upon allowance, included in the judgment or decree.

68 Stat. 253, 28 U.S.C. § 1923 provides:

> (a) Attorney's and proctor's docket fees in courts of the United States may be taxed as costs as follows:
>
> $20 on trial or final hearing (including a default judgment whether entered by the court or by the clerk) in civil, criminal, or admiralty cases, except that in cases of admiralty and maritime jurisdiction where the libellant recovers less than $50 the proctor's docket fee shall be $10;
>
> $20 in admiralty appeals involving not over $1,000;
>
> $50 in admiralty appeals involving not over $5,000;
>
> $100 in admiralty appeals involving more than $5,000;
>
> $5 on discontinuance of a civil action;
>
> $5 on motion for judgment and other proceedings on recognizances;
>
> $2.50 for each deposition admitted in evidence.
>
> (b) The docket fees of United States attorneys shall be paid to the clerk of court and by him paid into the Treasury.
>
> (c) In admiralty appeals the court may allow as costs for printing the briefs of the successful party not more than:

$25 where the amount involved is not over $1,000;
$50 where the amount involved is not over $5,000;
$75 where the amount involved is over $5,000.

Question Presented

Does the American Rule on attorneys' fees, as defined in *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240 (1975), permit an award of attorneys' fees in class actions to prevailing class action attorneys which award of fees is taken not only from money actually claimed by class members, but also from money that belongs to others?

Statement of the Case*

Respondents are a class of holders of bearer debentures of the petitioner Boeing Company ("Boeing") who, when Boeing called for redemption of the debentures, failed to convert them before the expiration of the conversion privilege.** After trial on both federal securities law and state law claims, the District Court held that Boeing had given all the notice required by the contract under which the debentures were sold and hence was not liable for the debentureholders' failure to convert. While the Court of Appeals in *Van Gemert I* agreed that Boeing had given all notice required by this contract, it held that Boeing should have given even more notice because the debentureholders

* A more detailed procedural history may be found in the panel and *en banc* opinions of the Court of Appeals (Appendices A and B).

** At the time of the call for redemption, the two shares of Boeing stock into which each $100 in principal amount of debentures was convertible were worth $316.25. The redemption value of the debentures was $103.25. Hence, holders who failed to convert on time lost $213 in value for each $100 in principal amount of debentures. 3a, 40a.

had an implied right to expect it. 73a. The Court of Appeals did not find that Boeing had engaged in any fraud or even that it had made any money as a result of its failure to convert late-tendered debentures. Boeing was merely held liable for the profit that the debentureholders could have made if they had converted and sold the common stock at prevailing market prices. 77a.

On remand, the District Court fixed damages without awarding interest and set the method of calculating attorneys' fees. The respondents appealed again, arguing, in relevant part, that class members filing claims for damages should be allowed to divide among themselves all damages remaining unclaimed, if only for the purpose of paying attorneys' fees. However, the Court of Appeals in *Van Gemert II* held that claiming class members had no right to unclaimed damages for any purpose, including paying attorneys' fees in whole or in part, because any such award would constitute a fluid class recovery or one benefitting a "next best class" contrary to *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005 (2d Cir. 1973), *vacated and remanded on other grounds,* 417 U.S. 156 (1974). 51a-52a.

On remand from *Van Gemert II,* Boeing deposited the damages and interest, which today amount to over $6,500,000, in a fund held by the Chase Manhattan Bank to be disbursed under the auspices of a Special Master, as directed by the District Court.* 41a-42a. The District Court also held that even though claiming class members could not directly invade the sums remaining unclaimed in order to pay their attorneys' fees, as *Van Gemert II* had held, these funds could be used on a pro rata basis to pay the attorneys' fees of the class. 40a-41a. It was and is undisputed that all

* Claims totalling approximately $2,000,000 have been filed to date.

money remaining unclaimed does not belong to the class.* *Van Gemert II, supra,* at 51a-52a.

In *Van Gemert III,* a panel of the Court of Appeals reversed, holding that under the American Rule on attorneys' fees, as defined by this Court in *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240 (1975), attorneys' fees could be taken only from the shares of those class members who made a claim for them and received a benefit from their attorneys' actions. Because the unclaimed money belonged to others for whose benefit the litigation had not been brought, attorneys' fees could not be charged against it. 29a, 33a-34a.

The Court of Appeals *en banc,* however, affirmed the District Court and by a divided vote held that class action attorneys could be paid fees not only from money actually claimed by class members, but also from money that did not belong to the class because it was never claimed.** 3a. Three grounds were stated for the decision.

First, a contrary decision would be inequitable to claiming class members and their lawyers "without any corresponding benefit to absentees". 3a. Since the unclaimed money, irrespective of ownership, is nevertheless "the spoils of . . . victory," those "spoils" could be used to pay attorneys' fees. 11a n.14.

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* Petitioner believes any unclaimed portions should be returned to it. New York State also asserted in a brief *amicus curiae* to the Court of Appeals *en banc* that unclaimed funds belong to it by virtue of their deposit in a New York bank.

** In its order granting review *en banc,* the Court of Appeals also asked the parties whether it was bound by *Van Gemert II* and the law of the case doctrine. In a footnote and contrary to decisions in two other Circuits the Court of Appeals held that it was not so bound. 6a n.9.

Second, a contrary decision would not be "sound policy" because it would "place enormous pressure on attorneys [for a class] to settle." 3a.

Third, "long-standing precedent" is said to support the decision. 3a. This precedent consists of but two cases, neither of which dealt with the issue before this Court and both of which were *explicitly* disavowed by this Court insofar as they might be construed to address this issue in *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240, 257-58 & n.30 (1975).

The three dissenting judges stated that the majority had "allowed [its] enthusiasm for class litigation to lead them into approving an award to attorneys that cannot be justified." 17a. The minority saw nothing in the case which "justifie[d] an award of substantial fees to lawyers for work purportedly performed on behalf of persons who are not their clients and who, themselves, have not received a single penny as a result of the lawyers' efforts." *Id.*

Reasons for Granting the Writ

There are two reasons why a writ of certiorari should issue to review the decision of the Court of Appeals for the Second Circuit. First, the decision of the Court of Appeals is contrary to the decision of this Court in *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240 (1975). *Alyeska* restated and defined a corollary to the American Rule on attorneys' fees, that in certain instances under 28 U.S.C. §§ 1920 and 1923 attorneys' fees may be borne by parties who are intended to be and actually are benefited by the efforts of the prevailing attorneys. The Court of Appeals decision destroys that holding as it relates to class actions by imposing such fees on non-beneficiaries of the lawsuit. This Court has consistently rejected, and repeat-

edly admonished against, attempts to alter established principles of law in connection with class action litigation, and the Court of Appeals decision substantially cuts away from those holdings. *See, e.g., Oppenheimer Fund, Inc.* v. *Sanders,* 98 S. Ct. 2380 (1978); *Gardner* v. *Westinghouse Broadcasting Co.,* 98 S. Ct. 2451 (1978); *Coopers & Lybrand* v. *Livesay,* 98 S. Ct. 2454, 2459, 2462 (1978); *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156, 176 (1974).

Second, a writ of certiorari should issue because, as the Court of Appeals *en banc* stated, this case is unusually "[significant] . . . for the conduct of class action litigation." 6a. A decision which enlarges so substantially the source from which class action attorneys' fees can be drawn, and which specifically denies that the size of that source should depend on whether class members care enough about the lawsuit to claim damages, will both encourage the bringing of lawsuits "not likely to benefit anyone but the lawyers who bring them," *Eisen* v. *Carlisle & Jacquelin,* 391 F.2d 555, 567 (2d Cir. 1968), and will encourage the continuation of such suits even after class members have lost interest in them. Indeed, the Court of Appeals admits that it is "structur[ing]" class action fee awards so that class action lawyers will not "be tempted to consider settling . . . for less than adequate sums." 16a-17a. In the short time since the Court of Appeals decision was filed, a case in which another court must decide whether to apply its rationale has already arisen. *American Timber & Trading Co.* v. *First National Bank,* Civ. No. 70-687 (D. Oregon).

POINT I

The Decision of the Court of Appeals Is Contrary to This Court's Decision in *Alyeska Pipeline Service Co. v. Wilderness Society.*

In *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240, 247 (1975), this Court stated:

> "In the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the losers. We are asked to fashion a far-reaching exception to this 'American Rule'; but having considered its origin and development, we are convinced that it would be inappropriate for the Judiciary, without legislative guidance, to reallocate the burdens of litigation in the manner and to the extent urged by respondents and approved by the Court of Appeals."

The statement could serve for this case as well. By holding that the attorneys for a class may receive their fees from claimed as well as unclaimed portions of a class action judgment, the Court of Appeals has directed that the legal fees of the victorious class be paid by some other person, *i.e.*, out of property that does not belong to the class. The Court did so by altering, for the benefit of class action lawyers, the American Rule and the "common benefit" corollary thereto.

This "common benefit" doctrine holds that in certain instances the financial burden of a lawsuit may be spread among unnamed parties for whose benefit the suit was brought *and* who were actually enriched by the results obtained. The early cases of *Trustees* v. *Greenough,* 105 U.S. 527 (1882), and *Central Railroad & Banking Co.* v. *Pettus,* 113 U.S. 116 (1885) are illustrative. In *Greenough,*

one beneficiary of a trust fund recovered assets which he and eleven other identifiable beneficiaries of the fund equally shared. In *Pettus,* one creditor established a lien on certain assets of a debtor, to the benefit of himself and a number of other creditors. In *Pettus,* this Court held that the attorneys' fee would be taken only from "the amount of all claims filed" against the assets on which the plaintiffs had established a lien. 113 U.S. at 127. Thus, attorneys' fees were taken only from the property of those who were actually enriched by the action.

In *Alyeska,* this Court set forth the unifying characteristics of cases falling within the common benefit doctrine: first, the classes of beneficiaries should be "small in number and easily identifiable"; second, the benefits should be able to be "traced with some accuracy"; and third, there should be "reason for confidence that the costs [can] indeed be shifted with some exactitude to those benefiting." 421 U.S. at 264 n.39.

In this case, it is not disputed that unclaimed portions of the judgment do not belong either to the class as a whole or to those members of the class who in fact file proofs of claim. *Van Gemert II, supra,* at 51a-52a; *Eisen* v. *Carlisle & Jacquelin, supra,* 479 F.2d at 1018.*

Nonetheless, the Court of Appeals held that attorneys' fees for class lawyers can be taken from these unclaimed funds. As a result, costs *will not* be imposed "with some exactitude" on those who benefit from this class action as *Alyeska* requires. Instead these costs will be extracted from the property of others. The Court of Appeals attempts to avoid this conclusion by ignoring those who will own the

* This unclaimed money belongs either to Boeing, the loser in this litigation, or to one or more state governments under theories of abandoned property. The Court of Appeals expressly declined to determine ownership of any unclaimed funds. 14a n.17.

property when the time for making claims on the fund expires and by creating a "benefit" in non-claiming members of the class solely for the purpose of assessing attorneys' fees. This "benefit" consists of no more than an "interest" in the class recovery which is never realized and which vanishes entirely after attorneys' fees are calculated.* 11a-12a. Even the generalized interest in protecting the environment which this Court found an insufficient benefit in *Alyeska* is far more real than this chimera.

The Court of Appeals relied principally on *Sprague* v. *Ticonic National Bank,* 307 U.S. 161 (1939), a case which was extensively argued to this Court in *Alyeska* by the respondents and *amici curiae,*** and was *expressly* limited in *Alyeska* insofar as *Sprague* suggests a view of the common benefit exception which is broad enough to justify imposing attorneys' fees on the property of a loser or other non-beneficiary of the litigation. 421 U.S. at 257-58 & n.30. As this Court stated in rejecting the argument that *Sprague* supported such a broad definition of the common benefit doctrine:

> *"Sprague* . . . might be read as suggesting that the Court in *Greenough* said that a federal court could tax [attorneys' fees] against the losing party . . . . But any such suggestion is without support either in the opinion in *Greenough,* which is limited to a common-fund rationale, or in [any federal] statute."

* The Court of Appeals also evaded the requirements of *Alyeska* that the beneficiaries be "easily identifiable" and traceable "with some accuracy," by tracing, not the many unknown and unfound debentureholders, but the debentures themselves, as if these numbered pieces of paper reaped the benefits of this action. 10a-11a.

** *See* Brief for Respondents at 3, 4, 36, 37, 38, 72, 81, 88-89, Brief of the Lawyers' Committee for Civil Rights Under Law *Amicus Curiae* at 5, 9, 10, 11.

Sprague holds only that because the plaintiff had established the indefeasible right of fourteen other trust funds as well as her own to certain assets of a bank, she could obtain attorneys' fees from these assets. The Court was not faced with the claim that attorneys' fees should be taken from property that had been determined not to belong to beneficiaries of the litigation.

Trustees v. *Greenough, supra,* the only other case relied on by the Court of Appeals, is still further from the mark. While this Court noted in *Greenough* that not all of the bondholder beneficiaries of the litigation had yet redeemed their bonds, an indefeasible right to a redemption for full value had been created which could be exercised at any time. 105 U.S. at 531. Thus an assessment of attorneys' fees on the entire fund was sure to be spread proportionately among all those who had concretely benefited from the lawsuit. The "favorable decree [had given] them all a proportionate advantage." 105 U.S. at 534. As this Court noted in *Alyeska,* the idea that attorneys' fees can be taken from one who is not enriched by the litigation "conflicts with any fair reading of *Greenough.*" 421 U.S. at 258 n.30.

The decision of the Court of Appeals, imposing attorneys' fees on property which does not belong to the class, is directly contrary to this Court's holding in *Alyeska.*

POINT II

The Decision of the Court of Appeals Will Significantly Affect the Conduct of Class Action Litigation by Allowing Class Action Attorneys to Collect Fees Which Are Disproportionate to the Benefits Actually Conferred.

Behind the Court of Appeals decision that attorneys' fees in a class action may be paid from portions of a judgment which are unclaimed and thus do not benefit any

class member, is the explicit premise that to do otherwise would be inequitable and unsound policy because class members would receive less money and class attorneys would be induced to settle cases in which few claims were expected. 3a, 16a-17a. Petitioner submits that the more important policy against abuse of the class action device that has been recognized by this Court was not considered by the Court of Appeals.

Rule 23 of the Federal Rules of Civil Procedure creates several special rules that make class actions different from other litigation. This Court has held, however, that outside those special rules class actions are governed "by the same standards that govern . . . other types of litigation." *Coopers & Lybrand* v. *Livesay,* 98 S. Ct. 2454, 2459 (1978). One of those standards is the requirement in any action for damages that a plaintiff be willing to aver that he seeks compensation before that compensation will be paid to him. *See, e.g., Decker* v. *Fillis,* 306 F. Supp. 613, 615-16 (D. Utah 1969). Rule 23 merely defers to the end of a case the requirement that, before any party receives damages, he be willing to prove his entitlement to them. This is done in order to allow entry into court of those willing to claim injury but not to undertake alone the expense of proving it.*

Once injury has been proven, the differences between class actions under Rule 23 and ordinary actions comes to an end. Each class member, like any other injured party, must come to court and make claims for damages in order to be paid. *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005, 1010 (2d Cir. 1973), *vacated and remanded on other grounds,* 417 U.S. 156 (1974). This is not a burden on a class member who feels his injury sufficiently to seek compensation for it.

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* Expenses of instituting an action and notifying the class of the existence of the litigation must of course be borne by the class. *Oppenheimer Fund Inc.* v. *Sanders,* 98 S. Ct. 2380 (1978).

Thus, a rule which compensates class attorneys on the basis of the number of class members who feel sufficiently injured to step forward brings into balance the benefits actually accorded with legal fees actually paid.

On the other hand, if class action attorneys are compensated, as the Court of Appeals held they must be, on the basis of the maximum possible award to the class, irrespective of whether or not anyone in the class actually receives any such benefits, these attorneys could be richly rewarded for establishing technical legal violations without regard to the possibility that any actual benefit will be conferred. *See In re Hotel Telephone Charges,* 500 F.2d 86, 91 (9th Cir. 1974). Indeed, under the Court of Appeals decision, maximum incentive would be given to such attorneys seeking such rewards. To reduce this potential, legal fees should be proportionate to benefits actually received by the class.

Further, if fees to the class' attorneys are awarded irrespective of the amounts actually claimed by the class for whose benefit the action is initially brought, there will be no incentive for such attorneys to play any role in seeking out their clients. If class attorneys may rely on being compensated on the basis of a theoretical maximum without regard to actual benefits conferred, they will have little incentive to expend much effort in locating class members. The most vigorous representation of the interests of the entire class could cease just at the time when such representation becomes most important.

The new rule of the Court of Appeals will also render more difficult the settlement of class actions because plaintiffs' attorneys will insist upon compensation for themselves based on the full fund claimed, even if it is agreed that a fair settlement for claiming class members is a much smaller amount. Thus a wider gap will be created between

what is sought by class plaintiffs and what defendants are willing to proffer. No public purpose other than enrichment of attorneys can possibly result from such a development.

It is submitted that the Court of Appeals decision in this case will ensure the proliferation of class action litigation by compensating attorneys far beyond any benefits in fact conferred by their efforts. The decision will also ensure protraction of these actions by class attorneys even when the class they represent has lost interest in the case. The importance to all class action litigation and of the issue raised by the Court of Appeals merits authoritative disposition by this Court.

CONCLUSION

Both because of the important effect of this decision on class action litigation, and because the decision is contrary to the common benefit exception to the American Rule on attorneys' fees as set forth in *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240 (1975), petitioners pray that a writ of certiorari issue to review the judgment of the Court of Appeals (*en banc*).

Dated: New York, New York
February 26, 1979

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 551—September Term, 1977.

(Submitted August 18, 1978 Decided December 21, 1978.)

Docket No. 77-7547

En Banc

WILLIAM R. VAN GEMERT, *et al.*,

Plaintiffs-Appellees,

—v.—

THE BOEING COMPANY
(formerly The Boeing Airplane Company), *et al.*,

Defendants-Appellants.

Before:

KAUFMAN, *Chief Judge,*
FEINBERG, MANSFIELD, MULLIGAN, OAKES,
TIMBERS, GURFEIN, VAN GRAAFEILAND and
MESKILL, *Circuit Judges.*

Appeals from an order entered in the United States District Court for the Southern District of New York, Sylvester J. Ryan, *J.*, awarding counsel fees, expenses and disbursements to be paid from the total amount of a class action judgment. Following a decision by a panel of this

court, 573 F.2d 733 (2d Cir. 1978), the court granted a rehearing *en banc*.

The order of the district court is affirmed.

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IRVING STEINMAN, New York, New York,

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GEORGE J. SOLLEDER, JR., Special Master, New York, New York, *amicus curiae.*

KAUFMAN, *Chief Judge*:

Attorneys litigating class actions have been variously described as "economically rational entrepreneurs," champions of aggrieved individuals for whom a conventional lawsuit would not be feasible, and the recipients of a "golden harvest of fees." These diverse perspectives, how-

ever, are united by a common theme of which we are not unaware. The conduct of class action litigation is affected by the principles governing the compensation of the attorneys who bring them.

Today we decide, in a case of first impression, that the fees and costs of counsel may be assessed against the unclaimed portion of a class action judgment. Our conclusion is predicated on considerations of equity and sound policy and is sustained as well by longstanding precedent. To hold otherwise, we believe, would engender serious unfairness to claiming class members and their lawyers, without any corresponding benefit to absentees. Moreover, a contrary result would place enormous pressure on attorneys to settle at all costs, and would deter them from instituting meritorious suits.

I.

In February 1966, the Boeing Company decided to call for redemption its issue of 4½% Converted Subordinated Debentures, due July 1, 1980. Pursuant to the terms of the Indenture Agreement, Boeing published notices of its intention in two national newspapers. Boeing also mailed notices to those investors who had registered their debentures. Holders of $1,544,300 of unregistered debentures, however, did not learn of the call until after the conversion deadline of midnight, March 29, 1966, set by Boeing.

At the stroke of twelve their right to convert $100 in principal of bonds into two shares of common stock expired. The two shares were worth $316.25 that day, but the unwitting bondholders were left only with the small consolation of having the right to redeem for $103.25, a figure fixed in the Indenture.

William Van Gemert and several other nonconverting bondholders brought a class action against Boeing, alleg-

ing that they had received inadequate and unreasonable notice of Boeing's decision. The plaintiffs contended that Boeing was civilly liable under the Securities Exchange Act of 1934,[1] the Securities Act of 1933,[2] the Trust Indenture Act of 1939,[3] and New York law.[4]

After a full trial, Judge Ryan dismissed the complaint, having held that Boeing was required to do no more than fulfill notice requirements stated in the Trust Indenture Agreement. On appeal, we decided that the New York law of contracts imposed an implied duty on Boeing—not satisfied by its newspaper advertisements and "eleventh hour" news release—to provide reasonable notice of its intention to redeem the debentures. Accordingly, we held that Boeing was liable despite its compliance with the notice provisions of the Indenture Agreement and remanded the case to Judge Ryan for a determination of damages. *Van Gemert* v. *Boeing Co.*, 520 F.2d 1373, 1383 (2d Cir. 1975) [*Van Gemert* I].

Judge Ryan then proceeded to calculate damages based on the difference between the redemption price of the debentures and the value, as of March 29, 1966, of the shares of common stock into which they could have been converted. We affirmed this ruling, but held, contrary to Judge Ryan, that the plaintiffs were entitled to prejudgment interest. *Van Gemert* v. *Boeing Co.*, 553 F.2d 812, 813 (2d

1 15 U.S.C. § 78f. The plaintiffs contended that Boeing was liable under the Act for violating the New York Stock Exchange Listing Agreement and Section A10 of the New York Stock Exchange Company Manual, on the theory that the statute requires stock exchanges to adopt such rules.

2 15 U.S.C. § 77a *et seq.*

3 15 U.S.C. § 77aaa *et seq.*

4 This claim was heard pursuant to the pendent jurisdiction of the federal courts. *See United Mine Workers* v. *Gibbs*, 383 U.S. 715 (1966).

Cir. 1977) (*Van Gemert* II). Since $1,544,300 in principal amount of unregistered debentures had not been converted, it was a simple task to determine that the class members had suffered damages in the sum of $3,289,359.[5]

In the *Van Gemert* II appeal, the law firm of Kass, Goodkind, Wechsler and Gerstein, a member of the committee of attorneys for the plaintiffs,[6] urged for the first time that members of the class who filed proper proofs of claim should be permitted to receive, on a pro rata basis, the unclaimed portion of the total damage award. Boeing responded in opposition that these funds should be returned to it. Without reaching a conclusion as to the ultimate disposition of unclaimed damages, we rejected the firm's proposal. *Id.* at 815-16. Such a plan, we held, constituted a form of fluid class recovery, involving distribution of the unclaimed portion of the judgment to a "next-best" class in contravention of *Eisen* v. *Carlisle & Jacquelin*, 479 F.2d 1005 (2d Cir. 1973), *vacated and remanded on other grounds*, 417 U.S. 156 (1974). We stated that the procedure suggested by the Kass firm would result in the expropriation of the claims of the silent class members and accordingly, create a windfall for those who filed claims. The panel also concluded that the proposal could not be justified on the ground that claiming class members would use a portion of the unclaimed funds to defray their legal expenses. This, it was decided, would require Boeing to pay indirectly for the legal expenses of successful litigants.

Upon a second remand to Judge Ryan for entry of judgment, he ordered that plaintiffs' attorneys be awarded

5 According to the report of the Special Master appointed by Judge Ryan, filed with this court as a brief *amicus curiae*, the judgment fund now exceeds $6,500,000, including prejudgment interest.

6 The other members of the committee were Nathan, Mannheimer, Asche, Winer & Friedman, and Irving Steinman.

their fees, expenses and disbursements from the total amount of the judgment. He concluded that it was equitable for all class members—claiming and nonclaiming alike—to bear a pro rata share of the costs of producing the judgment in their favor.[7] Boeing appealed this ruling as contrary to the mandate of *Van Gemert* II, contending that the attorneys should receive compensation only from the claimed portion of the judgment.

A panel of this court, in an opinion written by Judge Van Graafeiland, held that the claims of individual class members could not be treated collectively, as if they belonged to the class as a whole, and that because absent class members had not received the benefit of the attorneys' labors, no charge or assessment may be made against their undistributed shares. *Van Gemert* v. *Boeing Co.*, 573 F.2d 733, 736 (2d Cir. 1978) (*Van Gemert* III).[8]

Because of the significance of the issues in this case for the conduct of class action litigation, we decided to rehear the case *en banc*.[9] We now affirm the judgment of the district court.

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7 Under Judge Ryan's order, each class member's contribution to the total amount of attorneys' fees must bear the same ratio to all such fees as his own recovery bears to the total class recovery.

8 Judge Oakes dissented in part on the ground that the principles governing the award of attorneys' fees are inapplicable to costs and disbursements. *Van Gemert* III, 573 F.2d at 738.

9 Having briefed the issue at our request, Boeing presents the threshold argument that under the "law of the case doctrine," *Van Gemert* II precludes the recovery of costs and attorneys' fees from the unclaimed portion of the bondholders' judgment. We cannot accept this contention.

Van Gemert II held that class members who filed proofs of claim could not be awarded the unclaimed portion of the judgment on a pro rata basis, even if some of those funds were to be used to pay their lawyers. To allow the money judgment to be distributed in such a fashion would countenance "expropriation" of the shares of absentees, and would enable well-informed claimants to avoid paying any attorneys' fees at all. *Van Gemert* III raises the wholly different question whether the lawyers for the class may be awarded their fees and disbursements from the judgment considered as a common fund. The claiming class members will not receive a "windfall," for no payment of funds to a "next-best" class of persons is contemplated by Judge Ryan's order. Rather, the costs of the litigation will be borne by the entire fund, and each class member will be required to pay his proportionate share of attorneys' fees.

Even if *Van Gemert* II had reached the issue raised on this appeal, the law of the case doctrine would not dictate that we treat its ruling as dispositive. Boeing, citing *Bromley* v. *Crisp*, 561 F.2d 1351, 1363 (10th Cir. 1977) (*en banc*), *cert. denied*, 98 S. Ct. 1458 (1978), and *Lathan* v. *Brinegar*, 506 F.2d 677, 691 (9th Cir. 1974) (*en banc*), argues that it would be prudent for the court sitting *en banc* to consider itself bound by the law of the case established by a panel on an earlier appeal, when that ruling was not reviewed *en banc*.

We believe, however, that such a rule would be far too restrictive and that, sitting *en banc*, we may overrule any panel decision that a majority of the active judges believes was wrongly decided, unless a party would be seriously prejudiced as a result, *First National Bank of Hollywood* v. *American Foam Rubber Corp.*, 530 F.2d 450, 453 n.3 (2d Cir. 1976). The purpose of the "law of the case" doctrine is to prevent the continuous relitigation of issues decided by a panel at an earlier stage of a suit. The doctrine, which is in any event no more than an appeal to the "good sense" of the court, *see, e.g.*, *Zdanok* v. *Glidden Corp.*, 327 F.2d 944, 952-53 (2d Cir. 1964), is properly applied to the district court and to other panels of the Court of Appeals. It cannot immunize panel decisions from review by the court *en banc*. *Accord, In re Central R.R. Co.*, 485 F.2d 208, 210-11 (3d Cir. 1973) (*en banc*). And, given the rarity with which petitions for rehearing *en banc* are granted, the spectre conjured by Boeing of continual "second guessing" of panel decisions is insubstantial indeed.

II.

Any consideration of the propriety of awarding attorneys' fees in the federal courts must begin with *Alyeska Pipeline Service Co.* v. *Wilderness Society*, 421 U.S. 240 (1975). In that seminal case, the Supreme Court decided that, absent statutory authorization, the federal courts may not shift the costs of litigation from the winning to the losing party. The *Alyeska* Court noted, however, that there are two exceptions to this rule. First, there is inherent power in the courts to assess attorneys' fees for the "will-

ful disobedience of a court order," or when a party has acted in bad faith, *id.* at 258-59. Second, historically, the federal courts have exercised an equitable power to allow attorneys' fees and costs to be charged against a fund created, increased, or protected by successful[10] litigation. *Id.* at 257-58.

The application for the fees may be made by the plaintiffs themselves, *Trustees* v. *Greenough,* 105 U.S. 527 (1881), on the ground that they have performed a service benefiting others similarly situated. But a plaintiff's attorney may himself present a claim to compensation and reimbursement for expenses from the fund, on the theory that he has provided or preserved a benefit—the fund itself—and that the reasonable value of his services should be borne proportionately by all plaintiffs. *Central R.R. & Banking Co.* v. *Pettus,* 113 U.S. 116 (1885).

The paradigmatic common fund is an express trust, as in *Greenough.* Litigation can also "create" a fund, as when the assets of a debtor are brought within the reach of creditors, *Pettus, supra.* Nevertheless, the common fund doctrine has not been restricted to equitable actions in which the court exercised control over a "res". In *City of Detroit* v. *Grinnell Corp.,* 495 F.2d 448, 454, 468-69 (2d Cir. 1974), we awarded attorneys' fees out of the settlement fund in a private antitrust class action suit. Similarly, since a money judgment is itself an identifiable asset on which the trial court may impose a charge, such judgments have also been accorded common fund treatment, *see, e.g.,*

10 The common fund doctrine may be invoked only by successful litigants, *see Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240, 275 (1975). It "would be a strange inversion if the [common fund] doctrine enabled losers in adversary contests to charge their counsel fees to winners." Dawson, *Lawyers and Involuntary Clients: Attorney Fees from Funds,*" 87 Harv. L. Rev. 1597, 1626-27 (1974).

Union Cent. Life Ins. Co. v. *Hamilton Steel Prods., Inc.,* 493 F.2d 76 (7th Cir. 1974); *see generally,* Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation,* 88 Harv. L. Rev. 849, 920 (1975); Dawson, *Lawyers and Involuntary Clients: Attorney Fees from Funds,* 87 Harv. L. Rev. 1597, 1620-24 (1974).

In *Alyeska Pipeline Service Co., supra,* 421 U.S. at 265 n.39, the Supreme Court established criteria for determining whether benefits derived from litigation could properly be treated as a common fund. The Court stated that the common fund rationale was ill-suited to public interest litigation involving nebulous benefits accruing to a vast class of people. Accordingly, a common benefit did not accrue from litigation over the environmental impact of the trans-Alaska pipeline. The Court declared:

> In this Court's common-fund and common-benefit decisions, the classes of beneficiaries were small in number and easily identifiable. The benefits could be traced with some accuracy, and there was reason for confidence that the costs could indeed be shifted with some exactitude to those benefiting. In this case, however, sophisticated economic analysis could be required to gauge the extent to which the general public, the supposed beneficiary, as distinguished from selected elements of it, would bear the costs. *Id.*

We believe that the judgment against Boeing constitutes a common fund within the meaning of *Alyeska.*[11] The class

11 The common fund doctrine also presupposes that the court has "the authority to adjudicate the rights and duties" of those with an interest in the fund, Dawson, *supra,* note 10 at 1618. Although the beneficiaries need not sue as a class to meet this criterion, *United States* v. *ASCAP,* 466 F.2d 917, 919 (2d Cir. 1972), a class action presents the clearest case for the exercise of such judicial authority. The plaintiffs in the suit before us were certified as a 23 (b) (1) class

of debenture holders here is comparable in size to that of the creditors in *Pettus* and the bondholders in *Greenough*. Moreover, the *Van Gemert* class is smaller than the class of 85,000 union members in *Hall* v. *Cole*, 412 U.S. 1 (1973) and the 8,987 shareholders in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970)—two cases cited with approval in *Alyeska*.[12] Nor is the class membership here difficult to identify for the purposes of tracing the benefits accurately. Unlike the sprawling throng of potential beneficiaries in *Alyeska*—all those who would derive benefits from a pristine Alaskan wilderness—the beneficiaries of this action form a well-defined class, limited to those who failed to convert unregistered bonds of a specific issue of Boeing debentures. The names of the individual bondholders are not, to be sure, always ascertainable. But since each unconverted debenture is readily identifiable—and in fact bears an explicit number—it is quite evident that the damages owed to each plaintiff can be traced to each debenture with perfect accuracy. Elementary arithmetic, not "sophisticated economic analysis", is all that is required to determine the distribution of benefits. To calculate the amount of the judgment, it was necessary only to subtract the redemption price of each debenture from the value of the two shares of common stock to which it could have been converted. And it is equally simple to prorate the

under the Federal Rules. No class member could have opted out of such a suit even if he had desired to do so; once the class was certified, no other forum could have adjudicated their rights with respect to the fund.

12 In *Brennan* v. *United Steelworkers of America*, 553 F.2d 586 (3d Cir. 1977), the court ruled that a common benefit could accrue to a class of 1,400,000 union members, noting that the plaintiff class need not be small in "absolute numbers." *Id.* at 606. *See also, Yablonski* v. *United Mine Workers of America*, 466 F.2d 424 (D.C. Cir. 1972), *cert. denied*, 412 U.S. 918 (1973) (class of 162,000 union members).

cost of the suit with complete exactitude so that each debenture holder's recovery is taxed with the cost of vindicating his interest.[13] Indeed, the "identification" and "tracing" criteria are met more completely in the case before us than in either *Hall* or *Mills*, neither of which involved tangible economic benefits at all.

III.

The panel in *Van Gemert* III held that the common fund doctrine requires that expenses be assessed only against those who have actually claimed the fruits of the litigation, because no one else has benefited from the suit. We believe this construction of the concept of a "benefit" is too narrow and is not supported by the common fund case law. In *Greenough*, the Court noted that not every bondholder had filed claims against the fund, but nevertheless charged the entire fund with costs and fees. 105 U.S. at 529, 531. In *Sprague* v. *Ticonic National Bank*, 307 U.S. 161 (1939), the plaintiff sued individually to establish her right, as a beneficiary of a trust consisting of bonds held by a bank, to a lien on the proceeds from the sale of the bonds. In the process, she established the right of thirteen other beneficiaries to recover a share of the trust's assets. The Court, in an opinion by Justice Frankfurter, allowed the plaintiff to recover her attorney's fees out of those assets, although it was by no means clear that the other *cestuis que trust* would bring suit. If a plaintiff class-member is adjudicated to have an interest in a fund, he has benefited within the meaning of the common fund doctrine.[14]

13 *See* note 7 *supra*.

14 Citing the venerable Williston, our Brother Van Graafeiland maintains that the common fund doctrine is inapplicable unless the benefit conferred is knowingly accepted. Any requirement that the absentees

The rationale for such a rule is evident, as the case before us indicates. A portion of the judgment won by plaintiffs' attorneys—at least $213 for each unconverted debenture—is due every member of the class. Each plaintiff has a present vested interest in the class recovery, and his share of the judgment may be received on request. It cannot be urged convincingly, then, that the absent plaintiffs have not received a benefit from the litigation.

Our conclusion that the district court properly charged attorneys' fees against the shares of nonclaiming class members is far from heretical. At common law, an attorney's lien attached to a judgment obtained for his client, as security for his fees and expenditures. *See* Restatement (2d) Agency § 464(e). Under this doctrine, which is as

actually file claims, however, is foreclosed by *Sprague* and *Greenough*. Moreover, as *Haynes* v. *Rederi A/S Aladdin*, 362 F.2d 345, 351 (5th Cir. 1966), *cert. denied*, 385 U.S. 1020 (1967) noted, it is sufficient if the attorneys' services and the benefits accruing from it are "impliedly" accepted. Manifestly, plaintiffs in a 23(b)(3) class action, who have been provided with notice and an opportunity to opt out of the suit, must be said to have accepted the attorneys' services, and the benefits that may flow from them.

Of course, class actions certified under Rule 23(b)(2) or, as in this case, 23(b)(1), do not contain an opt-out privilege. This reflects the conclusion of those who drafted the Rules that individual choice should be subordinated to the interests of the class as a whole to avoid inconsistent judgments or prejudice to absent class members. Because class certification represents a judicial determination that the absentees are adequately represented, it would frustrate the Rule if we were to require an investigation into each plaintiff's willingness to accept the benefits of the litigation.

Our conclusion rests on firm foundations, for absentees are in no way harmed by our decision. It simply does not accord with fact to argue, as the minority seems to, that because a deduction from the shares of unnamed plaintiffs has been made for attorneys' fees, they are being held liable for *more* than they have gained. If, as we hold, they have benefited from the judgment, it is appropriate to charge them their *pro rata* share. And if, as the dissent contends, they have gained nothing by the victory against Boeing, then it is difficult to understand how a deduction from the spoils of that victory can be said to have injured them. The dissenters cannot have it both ways.

American as the "American Rule" against charging the losing party with the fees of his adversary, the attorney is *himself* entitled to have the judgment enforced and compensation paid, *id.* and comment n.; *Falcone* v. *Hall*, 235 F.2d 860 (D.C. Cir. 1956). Indeed, in *Pettus*, Justice Harlan noted that under state law the lien of plaintiffs' attorney could not be defeated by the successful purchase of the plaintiffs' claims. 113 U.S. at 127-28. Thus, since the attorney's right to his fee arose out of his creation of the judgment and not his client's receipt of the proceeds, our interpretation of the common fund doctrine is in harmony with time-honored principles of the common law.[15]

In contrast to the "expropriation" feared in *Van Gemert* II, deducting fees from each plaintiff's share in the judg-

15 The argument that there is no attorney-client relationship between the absentees and class counsel is not persuasive. A certification under Rule 23(c) makes the *class* the attorney's client for all practical purposes, *Developments in the Law: Class Actions*, 89 Harv. L. Rev. 1318, 1592-97 (1976). The judgment in a class action is not secure from collateral attack unless the absentees were adequately and vigorously represented. Without question, it is settled that the attorney is not free to advocate the interests of the named plaintiffs alone. *See Gonzales* v. *Cassidy*, 474 F.2d 67, 75-76 (5th Cir. 1973). And absentees do not cease to be clients simply because they fail to claim their portion of the class recovery.

It begs the question to argue that since absentees are not parties for all purposes, they cannot be parties when the objective is to award attorneys' fees. The absentees are certainly parties in the most fundamental sense, for, as we have already indicated, they are bound by the judgment. Whether a given procedural rule should be applied to those who are not named plaintiffs depends on the function of the rule. Absentees are not considered parties against whom counterclaims under Fed. R. Civ. P. 13 may be asserted, because "the right to counterclaim is readily subject to abuse as a tactical device to encourage plaintiffs to opt out." *See, e.g., Donson Stores, Inc.* v. *American Bakeries Co.*, 58 F.R.D. 485, 489 (S.D.N.Y. 1973). There can be no comparable objection to treating unnamed plaintiffs as parties for the purpose of assessing attorneys' fees, for no affirmative burden is placed on them by our ruling today. Indeed, it is only when the case is resolved in their favor, because of their counsel's efforts, that fees are assessed.

ment will not benefit some plaintiffs at the expense of others.[16] Each plaintiff will receive only his pro rata share of the recovery, less attorneys' fees, independent of the size of the unclaimed portion of the fund.[17] This is not a "fluid recovery" case.

We believe, moreover, that a ruling for Boeing would be unfair to both the claiming plaintiffs and the class attorneys, and would deter lawyers from bringing meritorious lawsuits. In setting attorneys' fees in class action litigation, courts must multiply the number of hours spent on the litigation by an appropriate hourly rate, and then adjust the fee to take into account the difficulty of the case, the attorney's risk in undertaking it, and the quality of representation.[18]

If victorious attorneys were permitted to charge fees only against claiming class members, the standards evolved by the courts to ensure rationality and fairness in fee setting would go for nought, because the compensation the attor-

16 We therefore do not find apposite to our holding today the concern expressed in *Van Gemert* II that claimants may be encouraged to keep absent class members uninformed about the judgment in their favor. In any event, the district judge will invariably require that adequate notice of the judgment be provided. In the instant case, Judge Ryan appointed a special master for this purpose, who sent notices to each individual whose name could be ascertained, and to all brokerage firms, banks, and other financial institutions, with instructions to transmit the notice to interested clients. Notice was also published once a week for three consecutive weeks in the *Wall Street Journal* and the *New York Times*.

Any alleged conflict of interest between the attorneys and the unnamed plaintiffs is vitiated here, as in every class action, by judicial supervision of the fee award.

17 We intimate no view as to the appropriate ultimate disposition of the remainder of the fund.

18 *See, e.g., City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448 (2d Cir. 1974); *Lindy Brothers Builders, Inc.* v. *American Radiator and Standard Sanitary Corp.*, 487 F.2d 161 (3d Cir. 1973).

ney received would be dependent on a purely fortuitous event. It would not suffice to adopt a rule that the attorney's fee should be set at a fixed sum, calculated by considering the factors described above, but chargeable only against the recovery of those who claimed their shares. In suits in which a relatively small number of claimants come forward, the attorney's fee would leave those claimants with no recovery at all—if, in fact, sufficient funds were claimed to pay the entire fee. In the instant case, each debenture holder had an economically significant interest in the litigation—and yet deducting attorneys' fees only from the claimed portion of the judgment may leave each plaintiff bereft of benefits.[19] Such a rule would indeed make this a "lawyer's lawsuit," *Van Gemert* III, *supra*, 573 F.2d at 735.

On the other hand, if we were to protect the plaintiffs by limiting the attorney to a fixed percentage of the judgment actually claimed, the resulting fee would be entirely dependent on the number of plaintiffs who came forward. Considerations of the difficulty of the case, the quality of representation, and the hours spent by the attorney, would not determine the ultimate size of the fee. Nor can the attorney always determine whether it would be worthwhile for him to undertake the risks of litigation, for the number of plaintiffs who will come forward after judgment is often unpredictable. Of course, the risk that only a fraction of plaintiffs will claim is greatest if the individual claims are small.[20] The percentage of class members who file claims,

19 Judge Ryan has not yet fixed the attorneys' fees in this case.

20 The drafters of Rule 23 (b) (3) contemplated that class actions would be utilized to enable those with individually non-viable claims to vindicate their interests. *See* Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure I*,

however, is not a function solely of the value of each plaintiff's stake in the litigation. In this very case, although the judgment gives each class member the right to twice his original investment in damages, only 20% of the judgment has been claimed after months of diligent efforts to locate absentees. The Special Master appointed by Judge Ryan attributed the low response to "both the passage of 12 years and the fact that the debentures were unregistered." [21] If the number of claiming plaintiffs were to become the dominant—indeed determinative—factor in setting appropriate attorneys' fees, lawyers would be discouraged from bringing class suits, regardless the merits of the case.

Refusing to charge fees against the entire judgment fund would also put a high premium on settling cases. When a class action is settled, the attorney's fee conventionally comes "off the top". *See, e.g., Blank* v. *Talley Industries,* 390 F. Supp. 1, 3 (S.D.N.Y. 1975) (Weinfeld, J.). The attorney is assured of the full amount of the fee that the court has found to be reasonable, regardless of whether some of his clients have failed to claim.[22] To be sure, in determining fair compensation the judge may take into account the number of plaintiffs likely to claim, *id.,* but the claimed portion of the fund does not place a ceiling on the fee. *See, e.g., Voege* v. *Ackerman,* 70 F.R.D. 693 (S.D.N.Y. 1976) (Weinfeld, J.). If an attorney's fee in a class action that goes to final judgment were so restricted, lawyers would be tempted to consider settling their clients'

81 Harv. L. Rev. 356, 397-98 (1967). The rule propounded by the dissenters would have a devastating effect on (b) (3) class suits.

21 Report of the Special Master, *supra* note 5, at 4.

22 Interim fees are often awarded after a settlement has been approved but before the parties have arrived at a plan of distribution to sub-classes—and, of course, before individual claims have been filed. *See* 3 H. Newberg, *Class Actions* § 6975 at 1263-66 & n.10 (1977).

claims for less than adequate sums. Fee awards should not be so structured as to encourage such conduct.[23]

Finally, our holding is perfectly consistent with the "American rule". The rationale of that doctrine is that litigants should not be deterred from pursuing *bona fide* claims or defenses by fear that they will be burdened by the costs and attorneys' fees of their successful adversary. *See Fleischman Distilling Corp.* v. *Maier Brewing Co.,* 386 U.S. 714, 718 (1967). Under today's decision, however, the fees of the attorneys for the class will be deducted from the amount for which Boeing has *already* been held liable. There is no "surcharge" on the defeated litigant.

Affirmed.

VAN GRAAFEILAND, J., dissenting
(with whom Judges MULLIGAN and TIMBERS concur):

With all respect to our colleagues in the majority, we believe they have allowed their enthusiasm for class litigation to lead them into approving an award to attorneys that cannot be justified under either contract or quasi-contract principles of law. In our view, there is no attorney-client relationship between the named plaintiffs' attorneys and the non-claiming absentee debenture holders upon which to base a claim reading in contract. Nor have the non-claiming absentees been unjustly enriched, so as to give the lawyers a quasi-contractual right of recovery based on quantum meruit. In short, we see nothing in this case that justifies an award of substantial fees to lawyers for work purportedly performed on behalf of persons who are not their clients and who, themselves, have not received a single penny as a result of the lawyers' efforts.

23 *See generally* Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest,* 4 J. Legal Studies 47, 56-60 (1975).

Little purpose would be served by simply repeating in this dissent what has already been said in prior opinions and is now being rejected by this en banc court. However, some repetition of both the law and the facts is necessary as a framework for the discussion that follows.

When Boeing, on July 15, 1958, offered its shareholders the right to subscribe to its debentures, the subscription rights were evidenced by warrants issued in the shareholders' names. Each warrant was fully negotiable, however, and could be transferred by delivery in blank. The transferee was entitled to use the warrant for subscription without having a new warrant issued. Approximately 7,000,000 rights were issued; and, between July 15, 1958, and July 29, 1958, the date the subscription offer expired, approximately 1,700,000 of them were traded on the New York Stock Exchange. During this same period, subscriptions having a total value of $29,578,500 were received by Boeing's transfer agent.

Between August 4, 1958, when the debentures were admitted to trading on the New York Stock Exchange, and March 29, 1966, when trading terminated, over $69 million in debentures were traded. Because the debentures, like the warrants, were in bearer form and negotiable upon delivery, there was no way of knowing in 1966 how many of them were still held by the original subscribers. Semi-annual interest on the debentures was collected by detaching a coupon and forwarding it to the Chase Manhattan Bank, the indenture trustee. A vast majority of the interest coupons were tendered to Chase by collecting banks on behalf of unidentified debenture holders. In those instances where coupons were tendered directly by debenture holders, Chase made a list of the tenderers which it retained for approximately six months.

As of March 8, 1966, there were approximately 27,000 debentures outstanding in the aggregate principal amount of $21,514,900. As of March 29, 1966, conversion rights had not been exercised for debentures in the face amount of $1,544,300.

During the next several months, ten separate actions were commenced against Boeing on behalf of non-converting debenture holders. The Van Gemert action was commenced on June 23, 1966. On July 21, 1966, upon the application of Boeing's attorneys, the district judge signed an order directing all present and former holders of unconverted debentures to show cause before him on September 6, 1966, why an order should not be entered determining that the action be maintained as a class action on their behalf, why they should not be permitted to appear and intervene in the action and present claims, if any, and why they should not be included in the class and bound by the final judgment. The court directed that Boeing give notice to the present and former debenture holders by mailing a court-approved form to those "whose addresses may be known to the defendants" and by publishing the notice twice a week for two successive weeks in the national editions of the New York Times and the Wall Street Journal. Because there was no way Boeing could identify each holder of the bearer debentures as of March 29, 1966, it compiled a list of persons who it believed might at some time have had an interest in the unconverted debentures and addressed notices to all of them.

No one knows, of course, whether each putative class member received a copy of the notice. No one knows how many of them may have been dead or incompetent when the notice was sent. Indeed, to this date, no one can accurately identify all of the class members. Those persons who did receive notice found no reference therein to any

legal representation for the class. No attorneys except Boeing's were named or described. Nothing was said about attorneys' fees or disbursements. No mention was made of a "fund" from which the attorneys would be paid.

These absentee debenture holders did not become clients of the attorneys for the named plaintiffs, nor of those attorneys who were subsequently appointed by the district court to serve as the "representative committee" of plaintiffs' attorneys. 3 H. Newberg, *Class Actions* ¶ 6824C at 1147 (1977). Indeed, for most purposes, the absentees could not even be considered parties to the law suit. *See In re Four Seasons Securities Laws Litigation*, 525 F.2d 500, 504 (10th Cir. 1975); *In re Sugar Industry Antitrust Litigation*, 73 F.R.D. 322, 348-49 (E.D. Pa. 1976); *Lamb* v. *United Security Life Co.*, 59 F.R.D. 44, 48-49 (D.C. Iowa 1973); *Donson Stores, Inc.* v. *American Bakeries Co.*, 58 F.R.D. 485, 489 (S.D.N.Y. 1973); 2 H. Newberg, *Class Actions, supra*, § 2780 at 1249-50 Accordingly, we fail to see the significance of the majority's discussion of attorneys' liens, "clients" who have failed to claim, and "parties" who must bear their own attorneys' fees.

We do see significance, however, in the fact that attorneys who profess to be representing the interests of absentee class members have no hesitancy in leaving them without representation when the matter of attorneys' fees is at issue. *Cf. Cherner* v. *Transitron Electronic Corp.*, 221 F.Supp. 55, 61 (D. Mass. 1963). We believe that once an attorney undertakes to represent class interests, it makes no difference by whom he was retained; he owes to all class members a duty of equal and fair representation. *Berner* v. *Equitable Office Bldg. Corp.*, 175 F.2d 218, 220 (2d Cir. 1949). A conflict of interest that prevents full and fair representation not only violates Rule 23 but also raises a serious question of lack of due process. *See Carroll* v. *American Federation of Musicians*, 372 F.2d 155,

162 (2d Cir. 1967), *vacated and remanded on other grounds*, 391 U.S. 99 (1968); *Phillips* v. *Klassen*, 502 F.2d 362, 366 (D.C. Cir.), *cert. denied*, 419 U.S. 996 (1974). If the absentee class members who have received nothing from the escrow fund were to discover that a group of unknown lawyers had received substantial awards from the absentees' undistributed shares, it is hard to believe that the absentees would not strenuously object to what must appear to them to be a lawyer's windfall. This is a viewpoint that should be expounded by the lawyers who claim to be the absentees' representatives. Instead, the lawyers advocate only their own cause and, as an incident thereto, the cause of their clients. This is a strange position indeed for lawyers who are seeking equitable relief from the courts. *Cf. National Association of Regional Medical Programs, Inc.* v. *Matthews*, 551 F.2d 340, 344-46 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977).

In *Van Gemert III*, 573 F.2d 733, we held that an award of fees under the equitable fund doctrine must be based on a theory of quantum meruit and that class attorneys should not be compensated for potential benefits not accepted by absent members of the class. Although we had no way of knowing at that time how much of the escrow fund would remain unclaimed, we stated that "the history of class litigation to date has demonstrated a surprisingly small response by absent members notified of their right to make claims." *Id.* at 736 n.4. This is one of the few statements in the opinion that has withstood the careful scrutiny of our learned colleagues. As Chief Judge Kaufman points out, claims representing only twenty percent of the escrow account have been filed, and the filing deadline was September 1, 1978.[1] Taking into account that the named plaintiffs

1 The notice of availability of proofs of claim stated that any debenture holder who did not file by the deadline date would be precluded from participating in the award of damages.

in the ten original lawsuits owned over ten percent of the unconverted debentures for which damages are being sought, the response by absentee holders is indeed small. At the present juncture, it appears that eighty percent of the fees and disbursements of the lawyers for the named plaintiffs will be paid from funds earmarked for absent class members who will not receive a penny.[2] We in the dissent do not believe that such a bizarre state of affairs can be justified simply by pointing to a "common fund" as the source of the lawyers' fees.

The "equitable" or "common" fund doctrine was created for the purpose of preventing unjust enrichment. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 391 (1970); *Fleischman Distilling Corp.* v. *Maier Brewing Co.*, 386 U.S. 714, 719 (1967); *Grace* v. *Ludwig*, 484 F.2d 1262, 1269 (2d Cir. 1973), *cert. denied*, 416 U.S. 905. There can be no unjust enrichment unless a benefit has been conferred and knowingly accepted. *Woodruff* v. *New State Ice Co.*, 197 F.2d 36, 38 (10th Cir. 1952); *In re Irving-Austin Bldg. Corp.*, 100 F.2d 574, 578 (7th Cir. 1938). *Williston on Contracts* puts it this way:

> Three elements must be established in order that a plaintiff may establish a claim based on unjust enrichment. These elements are:
>
> 1. A benefit conferred upon the defendant by the plaintiff;
>
> 2. An appreciation or knowledge by the defendant of the benefit; and

---

2 It is possible that the September 1st deadline may be extended by the district court and that additional filings may reduce somewhat the eighty percent figure. However, the principle that one should not be required to pay for something he has neither requested nor received remains the same, whether the figure is eighty percent or one percent.

> 3. The acceptance or retention by the defendant of the benefit under such circumstances as to make it inequitable for the defendant to retain the benefit without payment of its value.

12 *Williston on Contracts* § 1479 at 276 (3d ed. 1970).

This rule requiring a knowing acceptance of benefits applies to a fund created through the efforts of an attorney. *See Haynes* v. *Rederi A/S Aladdin*, 361 F.2d 345, 351 (5th Cir. 1966), *cert. denied*, 385 U.S. 1020 (1967); *Lea* v. *Paterson Sav. Inst.*, 142 F.2d 932, 934 (5th Cir. 1944). Newberg describes its application to class recovery funds as follows:

> Absent class members have no obligation to pay attorneys' fees and litigation costs, except when they elect to accept the benefit of the litigation. Absent class members who accept any part of any recovery fund are liable for their proportional share of fees and costs. The attorney who creates a fund is entitled to a fee from each class member who accepts the benefits of the fund.

2 H. Newberg, *Class Actions, supra*, § 2780 at 1249.

Another established rule of quasi-contract law is that an innocent recipient of benefits cannot be held liable to any greater extent than the amount by which he has been enriched. *Hill* v. *Waxberg*, 237 F.2d 936, 939 (9th Cir. 1956); *In re Irving-Austin Bldg. Corp., supra*, 100 F.2d at 578; *Dunn* v. *Phoenix Village, Inc.*, 213 F. Supp. 936, 952-53 (W.D. Ark. 1963); *Restatement of Restitution* § 1 comment e, § 155; Beale, *The Measure of Recovery Upon Implied and Quasi Contracts*, 19 Yale L.J. 609, 620-21 (1910).

No matter which of the foregoing rules is applied to the facts of this case, the order appealed from is wrong.

The Special Master's notice to debenture holders made it clear that receipt of the notice did not mean that the recipient would ultimately be found entitled to participate in the award of damages. The burden was placed upon the recipient to establish his right of recovery and to submit executed proofs of claim and supporting documents by September 1, 1978. If the non-claiming absentees were not precluded after September 1, 1978, from participating in the fund, the day will surely come when they will be. We are convinced that these individuals, thus precluded from sharing in the "common fund", cannot be said to have accepted the benefits of the lawyers' efforts. Any charge levied against them for attorneys' fees is clearly in excess of benefits received.

When the panel in *Van Gemert I*, 520 F.2d 1373, found Boeing's notice of redemption to be inadequate, it directed that damages be awarded to the seven percent of debenture holders who did not convert, without considering whether their failure to convert might have resulted from some cause other than lack of notice. All the non-converters had to do in order to collect was to file a claim. The Court now holds that, insofar as the attorneys' right of recovery is concerned, it isn't even necessary that a claim be filed by the debenture holders. Our brothers will not allow the absentees' failure to file, whether caused by death, incompetency, incapacity, lack of knowledge, or unwillingness, to prevent the lawyers from taking their cut of the unclaimed moneys.[3]

3 Perhaps, as the majority opinion intimates, we in the dissent are too much influenced by "venerable" works such as Williston on Contracts. Whatever the reason, we are unable to visualize a situation in which a non-converting debenture holder who died before the action was commenced can become a client of the "class" attorneys or can "impliedly" accept the benefits of the attorneys' efforts.

(footnote continued on next page)

This means that attorneys may sue on behalf of unknown and unnamed individuals, secure a money judgment, ostensibly on their behalf, and pocket a substantial part of the judgment funds earmarked for non-claiming absentees, without these absentees even knowing what has happened. Apparently, our colleagues in the majority either believe this is not occurring in the instant case or else deem its occurrence to be of no consequence.[4] We disagree on both counts. If lawyers must receive this sort of favored treatment to encourage the bringing of class actions, perhaps the game is not worth the candle; the public is giving up more than it is receiving in return.

We continue to believe that *Van Gemert III* was rightly decided, and we adhere to the views expressed therein.

We likewise cannot comprehend how the holder of a $100 debenture, who for any of a number of reasons does not collect, can be said to benefit to the same extent as the holder of a $100 debenture who does collect so that their "pro-rata" shares of attorneys' fees are the same.

4 The majority's attitude appears to be summed up in footnote 14 of the majority opinion where they say that deducting attorneys' fees from the "spoils" of the litigation cannot injure absentee class members who are not going to collect anyway.

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 551—September Term, 1977.

(Argued December 12, 1977 Decided March 27, 1978.)

Docket No. 77-7547

WILLIAM R. VAN GEMERT, et al.,

Plaintiffs-Appellees,

v.

THE BOEING COMPANY
(Formerly the Boeing Airplane Company) et al.,

Defendants-Appellants.

Before:

MULLIGAN, OAKES and VAN GRAAFEILAND,
Circuit Judges.

Appeal from a final order of Judge Sylvester J. Ryan of the United States District Court for the Southern District of New York which directed that plaintiffs' attorneys' fees be paid from the entire class fund rather than from that portion which is claimed by class members.

Reversed and remanded with instructions.

S. HAZARD GILLESPIE, New York, N.Y. (Davis Polk & Wardwell of counsel), *for Appellants, The Boeing Company (Formerly The Boeing Airplane Company), et al.*

STUART D. WECHSLER, New York, N.Y. (Kass, Goodkind, Wechsler & Gerstein of counsel), *for Appellees, William R. Van Gemert, et al.*

IRVING STEINMAN, New York, N.Y. (Samuel Weinstein of counsel), *for Appellees, William R. Van Gemert, et al.*

NORMAN WINER, New York, N.Y. (Nathan, Mannheimer, Asche, Winer & Friedman, of counsel), *for Appellees, William R. Van Gemert, et al.*

VAN GRAAFEILAND, *Circuit Judge:*

In 1975, this Court ruled that appellant Boeing did not give adequate notice of its intention to call certain convertible debentures and held it liable in this class action brought on behalf of debenture holders who failed to convert. *Van Gemert* v. *Boeing Company,* 520 F.2d 1373 (2d Cir.), *cert, denied,* 423 U.S. 947 (1975). Subsequent proceedings in district court resulted in an order directing the deposit of the amount of the judgment award, approximately six million dollars, in an escrow account in a New York City bank. A Special Master was appointed, with authority to receive and pass upon proofs of claim and to supervise the administration of the judgment.

The order provided further that the members of plaintiffs' committee of attorneys be awarded their fees, expenses and disbursements, as fixed by the court, payment thereof to be made from the total amount of the judgment.[1] The sole issue on this appeal is whether that portion of the escrow fund which is not claimed hereafter by class members can be charged with a pro rata share of the attorneys'

1 The district court ordered that affidavits in support of counsels' application for fees be submitted within twenty days of the entry of judgment.

fees and expenses. We hold that until absent class members receive the benefit of the attorneys' labors by claiming their portions of the award, no such charge or assessment may be paid from their undistributed shares.

The question of unclaimed funds has been before this Court on a prior appeal which followed our original decision on liability. *Van Gemert* v. *Boeing Co.,* 553 F.2d 812 (2d Cir. 1977). On that appeal, we rejected a request that the shares of non-claiming class members be distributed pro rata among claiming members in order to assist them in paying their legal fees and disbursements. Citing *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005 (2d Cir. 1973), *vacated and remanded on other grounds,* 417 U.S. 156 (1974), we held that the "extraordinary remedy" of fluid class recovery was not justified under the circumstances of this case.[2] *Van Gemert,* 553 F.2d at 815-16. Appellees now seek to avoid the effect of our prior holding by requesting only a portion of the unclaimed funds, with payment thereof to be made directly to their attorneys.

In so doing, they rely upon the equitable or common fund doctrine fathered by the leading cases of *Trustees* v. *Greenough,* 105 U.S. 527 (1881), and *Central Railroad & Banking Co.* v. *Pettus,* 113 U.S. 116 (1885). Under this doctrine, an attorney who creates or preserves a fund for the benefit of others in addition to his client may be awarded compensation from those who accept the fruits of his labors. *Pettus,* 113 U.S. at 125, 127. This award is not based upon the existence of an attorney's lien against the fund, but rather upon the equitable principle that those who benefit from the attorney's services should pay for them.

2 Because the Supreme Court vacated and remanded *Eisen* on other grounds, it did not pass upon the issue of fluid class recovery. However, the Ninth Circuit appears to share this Circuit's unwillingness to treat the class as a whole as a judicial entity for purposes of suit. *See In re Hotel Telephone Charges,* 500 F.2d 86, 89-90 (9th Cir. 1974).

General Finance Corp. v. *New York State Rys.*, 3 F. Supp. 975, 976 (W.D.N.Y. 1933) (quoting *In re Gillaspie*, 190 F. 88, 91 (N.D. W. Va. 1911)). More recent decisions, expanding on the concept of unjust enrichment, have held that under appropriate circumstances an attorney may have a right to compensation from the beneficiaries of his labors even though his efforts have not been directed toward the creation or preservation of a fund. *See, e.g., Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 391-97 (1970); *Sprague* v. *Ticonic Bank*, 307 U.S. 161 (1939); *Kopet* v. *Esquire Realty Co.*, 523 F.2d 1005, 1008 (2d Cir. 1975).

Appellees contend that the foregoing line of authorities justifies an award for attorneys' fees from the six-million dollar class award regardless of whether the entire award is distributed to class members. This argument has a surface appeal because it suggests a procedure that not only appears to be reasonable, but also is simple to apply. There are, however, other factors which must be considered in weighing the merits of appellees' proposal.

Class actions, termed by some as "lawyer's lawsuits", *see Developments in the Law—Class Actions*, 89 Harv. L. Rev. 1318, 1605 (1976), have received a good deal of criticism; and much of this has been directed at the substantial fees awarded to class attorneys. *See, e.g., Alpine Pharmacy, Inc.* v. *Chas. Pfizer & Co.*, 481 F.2d 1045, 1049-50 (2d Cir.), *cert. denied*, 414 U.S. 1092 (1973). Terms such as "golden harvest of fees", *Free World Foreign Cars, Inc.* v. *Alfa Romeo, S.p.A.*, 55 F.R.D. 26, 30 (S.D.N.Y. 1972), "astronomical fees", M. Blecher, *Is the Class Action Rule Doing the Job? (Plaintiff's Viewpoint)*, 55 F.R.D. 365, 366 (1972), and "enormous fees", Comment, 54 U. Det. J. Urb. L. 598, 611 (1977), are used to describe the allowances, which often run into the million of dollars.[3] Critics point

3 Counsel in this case are requesting fees of approximately two million dollars.

particularly to over-generous applications of the equitable fund doctrine, by means of which massive fees are awarded attorneys with too little regard for the interests of the class members. *See City of Detroit* v. *Grinnell Corp.*, 560 F.2d 1093, 1098 (2d Cir. 1977). This criticism, much of which is justified, prompts careful inquiry into whether it would be a misapplication of the equitable fund doctrine to permit counsel herein to collect part of their fees and expenses from the allocable shares of class members who claim none of the proceeds of the recovery.

Although the amendments to Rule 23 have been in effect since 1966, only a few class actions for damages have gone through a trial on the merits to judgment. *Eisen*, 479 F.2d at 1018-19; C. Wolfram, *The Antibiotics Class Actions*, 1976 Am. B. Foundation Research J., 251, 357; W. Simon, *Class Actions—Useful Tool or Engine of Destruction?*, 55 F.R.D. 375, 378 (1972); Note, *The Cy Pres Solution to the Damage Distribution Problems of Mass Class Actions*, 9 Ga. L. Rev. 893, 900 (1975). As a result, there has been little need to resolve the "troublesome question" of what to do with the unclaimed portion of a judgment for damages in favor of a class. *See Eisen*, 479 F.2d at 1012.[4] Fluid class recovery concepts have been adopted by a number of courts in actions which have terminated in settlement. *See, e.g., State of West Virginia* v. *Chas. Pfizer & Co.*, 314 F. Supp. 710 (S.D.N.Y. 1970), *aff'd.*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971).[5] However,

4 Although we do not know that there will be any unclaimed funds, the history of class litigation to date has demonstrated a surprisingly small response by absent members notified of their right to make claims. *See* F. Kirkham, *Complex Civil Litigation—Have Good Intentions Gone Awry?*, 70 F.R.D. 199, 206 (1976); W. Simon, *Class Actions—Useful Tool or Engine of Destruction?*, 55 F.R.D. 375, 377-78 (1972).

5 *But see B & B Investment Club* v. *Kleinert's Inc.*, 62 F.R.D. 140, 150 (E.D. Pa. 1974) where the Court said: "We do not perceive any reason

precedents involving settlements are of little help when a case has been litigated through trial to judgment. *Eisen,* 479 F.2d at 1012; *City of Philadelphia* v. *American Oil Co.,* 53 F.R.D. 45, 71 (D.N.J. 1971).

This Court expressed in *Eisen, supra,* its unwillingness to adopt the concept of fluid class recovery, and, on a prior appeal, we refused to apply it in this litigation, which is fundamentally a private dispute arising out of the debenture contract. *Van Gemert,* 553 F.2d at 815, 816. In *Eisen* we said that "the claims of many may not be treated collectively or as 'the class as a whole' . . . ." 479 F.2d at 1014. The compensation of appellees' attorneys must come therefore from the individual class members, not from the "class as a whole."

Although the holdings which follow *Greenough* and *Pettus* speak broadly of recovering attorneys' fees from funds, intrinsic in every case is the requirement that benefits must accrue to those against whom expenses are assessed. *See Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240, n.39 (1975). "The award of fees under the equitable fund doctrine is analogous to an action in quantum meruit: the individual seeking compensation has, by his actions, benefited another and seeks payment for the value of the service performed." *Lindy Bros. Builders* v. *American Radiator & Standard Sanitary Corp.,* 487 F.2d 161, 165 (3d Cir. 1973).[6] Those who receive no benefit from the lawyer's work should not be required to pay for it. *Schechtman* v. *Wolfson,* 244 F.2d 537, 540 (2d

why maximum exposure could not be provided for with provisions made, depending upon the claims presented, for a return of any excess to the defendants."

6 In *City of Detroit* v. *Grinnell Corporation,* 495 F.2d 448, 470 (2d 1974), this Court, quoting *Lindy,* said: "In its simplest terms, the purpose of the fee award is to 'compensate the attorney for the reasonable value of services benefiting the . . . claimant.'"

Cir. 1957); *Nolte* v. *Hudson Nav. Co.,* 47 F.2d 166, 168 (2d Cir. 1931); *Simmons* v. *Friday,* 190 F.2d 849, 852 (8th Cir. 1951); *In re Irving-Austin Bldg. Corp.,* 100 F.2d 574, 578 (7th Cir. 1938); *Baltic Independent School District* v. *South Dakota High School Activities Association,* 362 F. Supp. 780, 786 (D. S. Dak. 1973); *cf. City of Miami Beach* v. *Jacobs,* 341 So. 2d 236 (Fla. Dist. Ct. App. 1976), *cert. denied,* 348 So. 2d 945 (Fla.), *cert. denied,* 98 S.Ct. 430 (1977). In a private action for damages such as this, "[t]here is no reason why the attorneys should be compensated for potential benefits not accepted by members of the class." *Blank* v. *Talley Industries, Inc.,* 390 F. Supp. 1, 6 (S.D.N.Y. 1975); *see also* 2 H. Newburg, *Class Actions,* ¶2780 at 1249 (1977); E. Labowitz, *Class Actions in the Federal System and in California: Shattering the Impossible Dream,* 23 Buf. L. Rev. 601, 647 (1974); *cf. Miller* v. *Union Barge Line Corporation,* 299 F. Supp. 718, 721 (W.D. Pa. 1969).

The application of this rule should cause no administrative difficulties on remand. Having directed the creation of an escrow account for the total amount of the possible recovery, the district court must now set a reasonable period of time for the proof of claims by class members. Because both administrative expenses and attorneys' fees and disbursements are to be charged pro rata against the awards to class members, payment of the awards must be deferred until the Special Master has completed processing the claims and his fees and expenses can be determined. At that point, the benefits accruing to class members can be "traced with some accuracy", and the costs can be "shifted with some exactitude to those benefiting." *Alyeska,* 421 U.S. at 265 n.39. The district court may then make an appropriate award for attorneys' fees and expenses.

If any funds remain unclaimed, the Court must make appropriate disposition of them. Because it is conjectural

as to whether there will be any unclaimed funds and because we have not been asked to consider the question of their disposition on this appeal, we express no present view on this matter. Recognizing, however, the possibility that unclaimed funds will be returned to the defendant,[7] we point to the Supreme Court holding in *Alyeska* as an additional reason why attorneys' fees should not now be charged against the entire escrow fund.

Reversed and remanded for further proceedings in accordance with this opinion.

OAKES, *Circuit Judge* (dissenting in part):

I first disavow the rhetoric of the majority directed at class actions and "class action lawyers." Class actions often are valuable tools for the individual plaintiff seeking justice against a defendant whose resources enable it to obtain the highest-paid lawyers to engage in such extensive discovery and other litigation techniques that one, two or three plaintiffs otherwise could never afford to conduct the lawsuit. This very case exemplifies the usefulness of class actions. Holders of $1.5 million of debentures that were worth $4 million only if converted by a given deadline were given inadequate and unreasonable notice of Boeing's intention to redeem the debentures and of the conversion

7 Those advocates of fluid class recovery who view class actions primarily as deterrents against wrongful conduct urge that unclaimed funds be disposed of in a manner similar to the cy pres doctrine of the law of trusts, or that they escheat to the state. 7A Wright & Miller, *Federal Practice and Procedure* § 1784 at 64 (Supp. 1976); S. Gordon, *Manageability Under the Proposed Uniform Class Actions Act*, 31 Sw. L.J. 715, 725 (1977); *Uniform Class Actions*, 63 A.B.A.J. 837, 842 (1977). However, even some proponents of fluid class recovery concede that under some circumstances it may be appropriate to return unclaimed funds to the defendant. *See, e.g.*, Uniform Class Actions Act (U.L.A.) § 15(b).

deadline. The class members therefore failed to exercise their conversion rights by the deadline. *Van Gemert* v. *Boeing Co.*, 520 F.2d 1373, 1378, 1383 (2d Cir.) (*Van Gemert I*), *cert. denied*, 423 U.S. 947 (1975). A decade of hard-fought difficult litigation has at last resulted in an award to the debenture holders which, had the original notice been sufficient, would have rightfully been theirs for the asking. In the process, against uphill odds, the lawyers for the now successful plaintiffs did an extraordinarily capable job, having even "made new law" on a complicated set of facts. Thus, criticism against class actions generally or plaintiffs' attorneys' fees in particular[1] falls flat when focused on the case at bar.

I am required to agree, however, with the basic theory of the majority opinion—that attorneys' *fees* are recoverable solely from the class members who file proper proofs of claim, rather than from the entire class fund—because so-called fluid class recovery was rejected in *Van Gemert* v. *Boeing Co.*, 553 F.2d 812, 815-16 (2d Cir. 1977) (*Van Gemert II*),[2] relying on *Eisen* v. *Carlisle & Jacquelin*, 479 F.2d 1005 (2d Cir. 1973), *vacated and remanded on other grounds*, 417 U.S. 156 (1974). *Van Gemert II* is the "law of the circuit"; absent en banc treatment of the issue I am bound to follow it, therefore, whether or not I agree.

But this court's rejection of fluid class recoveries does not end the inquiry here. It seems to me that there is a

1 Those who criticize the fees of class action plaintiffs' lawyers seem to overlook the fees charged by class action defendants' lawyers. Could it be that a double standard is being applied?

2 *Van Gemert II* rejected the proposition that class members who file proper proofs of claim should be entitled to pro rata distribution of the unclaimed portion of the damage award. In doing so, it found unconvincing the argument that the unclaimed funds should be awarded to the claiming members of the class to defray their legal expenses. I agree with the majority to the extent that this holding precludes use of the unclaimed funds to pay the legal fees of class action attorneys.

sharp distinction between attorneys' fees and attorneys' disbursements. Plaintiffs' attorneys' fees in class actions generally being contingent, as they are here, are earned only if there is recovery. And *Van Gemert II's* implicit holding, *see* note 2 *supra,* that attorneys' fees may not be imposed on unclaimed funds, must be based on a similar theory—when there are no claimants, there is no "recovery"; thus this portion of the fund has not been "earned." Reimbursement of disbursements, by contrast, is not dependent on success. In fact, attorneys are precluded from expending funds on behalf of their clients unless the client remains ultimately liable for the expenses. *See* ABA Code of Professional Responsibility, Canon 5, Ethical Consideration 5-8, Disciplinary Rule 5-103(B). Accordingly, the number of ultimate claimants should not affect an attorney's right—perhaps his duty—to recover all disbursements from the entire fund. Additionally, fundamental principles of fairness underlying established law relating to recovery of expenses from a common fund,[3] *see Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375, 389-97 (1970), militate in favor of permitting repayment of attorneys' disbursements out of the fund as soon as it is established. These expenses, incurred for the benefit of all, are necessary if there is to be recovery by anyone. Attorneys who advance such sums do so expecting, as they must, reimbursement. Furthermore, if they are only repaid per claimant—that is, by computing the amount that each class member would have to contribute if the whole award were claimed, and then charging the claiming class members for disbursements as if all potential claimants had filed—the attorneys would have to bear the loss for the portion of out-of-pocket costs attributable to entitled class members

3 *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240, 257, 264-65 n.39 (1975), expressly preserved the common fund doctrine.

who failed to file their claims.[4] This result simply does not make common sense. I therefore dissent in part.

4 Of course, if the filing claimants were required to absorb the total disbursements out of their pro rata share of the recovery, the attorneys would obtain complete reimbursement. But this would reduce the filing claimants' compensation and, in turn, be unfair to them.

The result of the majority decision, *ante* at 2099-2100, is either that the attorneys absorb the disbursements attributable to unfiled claims or that the claiming members of the class end by being responsible for paying all attorneys' disbursements—perhaps even fees—from their shares of the award. With either result I disagree.

APPENDIX C

Judgment and Order

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

66 Civ. 1820 (SJR)

WILLIAM R. VAN GEMERT, *et al.*,

Plaintiffs,

—against—

THE BOEING COMPANY (formerly BOEING AIRPLANE COMPANY) and THOMAS R. WILCOX,

Defendants.

A judgment having been duly entered in the above action on December 30, 1976 pursuant to an order of this Court dated December 27, 1976 adjudging and decreeing that plaintiffs, in behalf of all members of the plaintiff class, shall recover as their damages herein the principal sum of $3,289,359 and that all members of the plaintiff class shall be entitled to receive interest at the rate allowed in this District from the date of said judgment to the date of payment, and containing other provisions as therein more fully set forth, and an appeal having been taken by plaintiffs individually and on behalf of the members of the class to the United States Court of Appeals for the Second Circuit from so much of the judgment and order which denied prejudgment interest on said sum of $3,289,359 from March 29, 1966 and denied plaintiffs appellants' claim that said damage sum awarded should be increased to $4,026,762, and the Court of Appeals having rendered its decision on April 18, 1977 affirming in part and reversing in part the judgment and order appealed from and remanding the case to

the District Court, Southern District of New York, affirming the damages awarded to plaintiffs and the class and reversing that portion of the judgment which directed that no pre-judgment interest be awarded, holding that under N.Y.C.P.L.R. § 5001(a) an award of interest at the legal rates from the date of the breach, March 29, 1966, was mandatory.

Now upon the said opinion and mandate of the United States Court of Appeals for the Second Circuit in the above entitled action decided April 18, 1977, it is hereby

ORDERED, ADJUDGED AND DECREED that plaintiffs in behalf of all members of the plaintiff class, which consists of all holders on March 29, 1966 of 4½% Convertible Subordinated Debentures of the Boeing Company who failed to exercise their conversion right before it terminated on March 29, 1966, shall recover as their damages herein from the defendants the principal sum of $3,289,359 together with interest thereon at the legal rates fixed by the State of New York, N.Y.C.P.L.R. § 5001(a) from March 9, 1966 to the date of this judgment, with costs to be taxed; and it is further

ORDERED that the members of the Plaintiffs Committee of Attorneys be awarded their fees, expenses and disbursements as fixed by the Court to be paid out of said total amount of this judgment; and it is further

ORDERED that each member of the plaintiff class who has not heretofore redeemed his debenture shall be entitled to receive the sum of $316.25 for each $100 face amount of debenture together with interest as set forth above, plus interest upon the redemption value of $103.25 from March 29, 1966 to the date of payment to the debenture-holders, after deducting such class member's proportionate share of the total amount allowed for attorneys' fees, expenses and disbursements; each class member's proportionate

share shall bear the same ratio to all such fees, expenses and disbursements as such class member's recovery shall bear to the total recovery provided for herein; and it is further

ORDERED that each member of plaintiff class who has heretofore redeemed his debenture shall be entitled to receive the sum of $213 for each $100 face amount of debentures together with interest as set forth above, plus interest upon the redemption value of $103.25 from March 29, 1966 to the date of redemption, after deducting such class member's proportionate share of the total amount allowed for attorneys' fees, expenses and disbursements; each class member's proportionate share shall bear the same ratio to all such fees, expenses and disbursements as such class member's recovery shall bear to the total recovery provided for herein; and it is further

ORDERED that within 15 days after the entry of this judgment the defendants shall deposit the amount of this judgment plus interest at the rate of 6% per annum to the date of such deposit, in a commercial bank, a savings institution or other depository in the Borough of Manhattan, City of New York, upon which interest shall accumulate until disbursed, and that such monies shall be so held in escrow pending the further order of this Court; and it is further

ORDERED that affidavits in support of the fees to be awarded to the attorneys for the class shall be submitted to this Court within twenty days after the entry of this judgment; and it is further

ORDERED that George J. Solleder Jr., Esq., of 19 Rector Street, New York, New York, Telephone Number BO 9-2222, is hereby appointed Special Master with all the powers enumerated in Rule 53 of the Federal Rules of Civil Pro-

cedure to direct the parties in the necessary ministerial steps to effectuate the Judgment, receive all proofs of claim to participate in the Fund established by the Judgment, pass on the validity of same, direct the giving of notices to interested persons of hearings on disputed claims, conduct the necessary hearings, submit reports thereon and in general supervise the administration of the Judgment and decide all disputed questions of law and fact connected therewith subject to confirmation by the Court; all expenses incurred by the Special Master, including his fee, shall be paid out of the Fund; and it is further

ORDERED that this Court shall reserve and retain jurisdiction of this action pending the implementation of this order and judgment, for the making of such further orders or any other acts as may be necessary to carry out the purpose of this order and judgment.

Dated: New York, New York
June 30, 1977

/s/ SYLVESTER J. RYAN
U.S.D.J.

WILLIAM R. VAN GEMERT, *et al.* v. THE BOEING COMPANY and THOMAS R. WILCOX

ENDORSEMENT

---

66 Civ. 1820

Defendants' motion for an Order amending a portion of the Judgment and Order of this Court dated June 30, 1977 is denied.

The following parts of the Judgment and Order are claimed by the movants to be contradictory and violative of the Court of Appeals decision in this case (553 F.2d 812) and the holdings in other cases cited in the supporting memorandum.

> "ORDERED that the members of the Plaintiffs Committee of Attorneys be awarded their fees, expenses and disbursements as fixed by the Court to be paid out of said total amount of this judgment; . . .".
>
> • • •
>
> "after deducting such class member's proportionate share of the total amount allowed for attorneys' fees, expenses and disbursements; each class member's proportionate share shall bear the same ratio to all such fees, expenses and disbursements as such class member's recovery shall bear to the total recovery provided for herein; . . .",

These provisions do not depart from the Court of Appeals decision. The Court of Appeals ruled that those class members who file proofs of claim are not entitled to either a pro rata portion of the damage award which remains unclaimed nor to the unclaimed funds in order to defray the legal expenses of the claiming members.

Under the circumstances of this protracted suit, it is equitable that all class members both claiming and non-claiming, if any, bear a pro rata portion of the fees, expenses, disbursements and administration costs and the Judgment and Order so provides.

So ordered.

Dated: New York, New York
September 22, 1977

/s/ SYLVESTER J. RYAN
Senior U.S. District Judge

APPENDIX D

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Nos. 879, 880, Dockets 77-7009, 77-7031

Argued Feb. 25, 1977

Decided April 18, 1977

WILLIAM R. VAN GEMERT et al.,

Plaintiffs-Appellants,

v.

THE BOEING COMPANY AND THOMAS R. WILCOX,

Defendants-Appellees.

Before MANSFIELD and VAN GRAAFEILAND, Circuit Judges, and MISHLER, District Judge.*

VAN GRAAFEILAND, Circuit Judge:

This appeal arises from a consolidated class action brought by non-converting holders of the Boeing Company's 4½% convertible subordinated debentures due July 1, 1980. The amended complaint alleges that appellants had received inadequate notice of Boeing's intention to call the convertible debentures in question and were therefore unable to exercise their conversion rights prior to the deadline for the call which was midnight, March 29, 1966. The redemption price for each $100 of principal amount of debentures was $103.25. However, if appellants had been able to meet the call deadline, they could have converted each $100 of principal amount of debentures into at least

* Chief Judge, Eastern District of New York, sitting by designation.

two shares of common stock. On March 29, 1966 the common stock obtainable for each $100 of debentures was worth $316.25. Within thirty days thereafter the stock was worth $364. Damages demanded by appellants are based on the difference between the redemption price and the value of the common stock.

Originally, the District Court dismissed the complaint. On appeal, this Court reversed that judgment and remanded to the District Court for a determination of damages. *Van Gemert* v. *Boeing Co.*, 520 F.2d 1377 (2d Cir.), *cert. denied*, 423 U.S. 947, 96 S.Ct. 364, 46 L.Ed.2d 282 (1975). District Judge Ryan has now made that determination, and the case is once again before this Court.

Judge Ryan awarded damages based on the value of Boeing's common stock on March 29, 1966, which, as noted previously, was the cut-off date for the exercise of conversion privileges. He awarded no prejudgment interest. Appellants take exception to both of these rulings. They contend that, under New York's "fluctuating value" test, Judge Ryan should have valued the Boeing common stock as of April 14, 1966, when two shares of that stock were worth $364. Additionally, appellants assert that the District Court should have awarded prejudgment interest. We believe that Judge Ryan properly valued the stock as of March 29, 1966. However, we agree with appellants that they are entitled to pre-judgment interest.

[1] We are satisfied that *New York law controls* both of these questions. In our prior opinion, we found that appellants' federal claims were sufficient to provide the District Court with jurisdiction over the case. *Id.* at 1382. However, the relief granted appellants was founded on State law. In finding that Boeing had failed to provide the debenture holders with reasonably adequate notice of the redemption, we held that:

> The duty of reasonable notice arises out of the contract between Boeing and the debenture holders, pursuant to which Boeing was exercising its right to redeem the debentures.

Id. at 1383. It is the source of the right, not the basis of federal jurisdiction, which determines the controlling law. *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 726, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966); *Maternally Yours, Inc.* v. *Your Maternity Shop, Inc.*, 234 F.2d 538, 540 n.1 (2d Cir. 1956); *see* 13 C. Wright, A Miller & E. Cooper, Federal Practice and Procedure § 3567, at 462 (1975). Consequently, in determining the proper measure of damages, New York State law is controlling.

Appellants urge us to apply the "fluctuating value" rule formulated by the New York courts for situations where there has been a conversion of stock. Succinctly stated, this rule provides that:

> The measure of damages for conversion of stock certificates is the cost of replacement within a reasonable period after the discovery of the conversion, regardless of when the conversion may have occurred .... (Citations omitted).

Hartford Accident & Indemnity Co. v. *Walston & Co.*, 22 N.Y.2d 672, 673, 291 N.Y.S.2d 366, 367, 238 N.E.2d 754 (1968). This rule does not apply to the facts of the instant case, however.

In both *Baker* v. *Drake*, 53 N.Y. 211 (1873) and *Mayer* v. *Monzo*, 221 N.Y. 442, 117 N.E. 948 (1917), cases relied upon by appellants, it was alleged that stockbrokers sold their principal's stock without authorization. The owners of the stock were holding these securities, hoping to realize a profit from their sale. *Baker* v. *Drake, supra*, 53 N.Y. at 216. The *Baker* court explained the theory on which damages

would be awarded when stock held for this purpose was converted.

> If, upon becoming informed of the sale, he desired further to prosecute the adventure and take the chances of a future market, he had the right to disaffirm the sale and require the defendants to replace the stock. If they failed or refused to do this, his remedy was to do it himself and charge them with the loss reasonably sustained in doing so. The advance in the market price of the stock from the time of the sale up to a reasonable time to replace it, after the plaintiff received notice of the sale, would afford a complete indemnity.

Baker v. *Drake, supra,* 53 N.Y. at 217.

The situation presented in the instant case is wholly different from the circumstances existing in *Baker* and its progeny. Here, appellants never owned any common stock of Boeing and do not claim to have purchased any. *See Hartford Accident & Indemnity Co.* v. *Walston & Co., supra,* 22 N.Y.2d at 673, 291 N.Y.S.2d 366, 238 N.E.2d 754. In reality, appellants are asking us to treat them as if they were owners of the stock on the cut-off date, March 29, and to speculate that they would have sold these shares at the highest price reached within a reasonable time thereafter. Such a theory of damages was specifically rejected in *Simon* v. *Electrospace Corp.*, 28 N.Y.2d 136, 145, 320 N.Y.S.2d 225, 269 N.E.2d 21 (1971).

[2] In our former opinion we held that appellants' right to damages arose out of their contract with Boeing. *Van Gemert* v. *Boeing Co., supra,* 520 F.2d at 1383. We are confident that, faced with the facts presented here, the New York courts would apply a breach of contract theory of damages, resulting in the Boeing stock being valued as of the cut-off date, March 29, 1966. In *Simon* v. *Electrospace*

Corp., supra, the defendant breached its contract to deliver shares of stock to the plaintiff for services rendered. The *Simon* court stated:

> The proper measure of damages for breach of contract is determined by the loss sustained or gain prevented at the time and place of breach . . . . The rule is precisely the same when the breach of contract is nondelivery of shares of stock . . . . Plaintiff was never the owner of the stock of Electrospace just because defendant breached its contract to deliver the shares. That breach and the loss caused was fixed and determined in 1967 . . . [and that was] the time when the value to him of defendant's performance was to be measured. It was then that plaintiff was to be made whole and not at some future time never specified in the agreement. (Citations omitted).

Simon v. *Electrospace Corp., supra,* 28 N.Y.2d at 145, 320 N.Y.S.2d 225, 232-233, 269 N.E.2d 21, 26. The cases dealing with converted stock were referred to by the *Simon* court but did not control, because there, as here, the plaintiff did not own the stock. Boeing had the right to call the debentures as of March 29, 1966. However, it breached its contract with the debenture holders by failing to give them reasonably adequate notice of its action, thereby precluding them from participating in the call. We hold that the breach occurred on March 29, 1966; and, for the purpose of computing damages herein, the Boeing stock should be valued as of that date.

New York law also controls on the issue of pre-judgment interest. Appellants contend that the awarding of interest is mandatory under N.Y.C.P.L.R. § 5001(a). Boeing, on the other hand, asserts that our previous decision in effect reformed the contract between it and the debenture holders. Because reformation is an equitable doctrine, *see Brand-*

wein v. *Provident Mutual Life Insurance Co.*, 3 N.Y.2d 491, 494, 168 N.Y.S.2d 964, 146 N.E.2d 693 (1957), Boeing argues that the awarding of interest was discretionary with the District Court.

[3, 4] Boeing's reliance on the doctrine of reformation is misplaced. In our prior decision, we did not rely on a mutual mistake between the parties in expressing the terms of their agreement. Neither did we find unilateral mistake on the part of the debenture holders occasioned by Boeing's fraud. We did find significant, however, the fact that the debentures did not explicitly set forth the type of notice which appellants could expect if Boeing decided to call the bonds. Without such a declaration, we held as a matter of law that appellants were entitled to expect that Boeing would employ a method of notification reasonably calculated to inform the debenture holders of the call. In doing so, we merely applied the settled principle, "that in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract . . . ." *Kirke La Shelle Co.* v. *Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933). Simply stated, every contract contains the implied requirement of good faith and fair dealing. Boeing was found liable therefore because it breached its contract with appellants, and damages were awarded. Under N.Y.C.P.L.R. § 5001(a), an award of interest from the date of the breach, March 29, 1966, is mandatory. *See Spang Industries, Inc.* v. *Aetna Casualty & Surety Co.*, 512 F.2d 365, 371 (2d Cir. 1975).[1]

[1] On remand, the District Court should compute interest at the various legal rates applicable under New York law during the period from March 29, 1966 to the date that judgment is entered. *Spang Industries, Inc.* v. *Aetna Casualty & Surety Co., supra*, 512 F.2d at 372; *see Kaufman* v. *Chase Manhattan Bank National Association*, 370 F.Supp. 279, 280 (S.D.N.Y. 1974).

[5] On March 30, 1966, $1,544,300 in principal amount of unregistered debentures had not been converted. Therefore the class as a whole suffered damages of $3,289,359, exclusive of pre-judgment interest. This sum with interest represents the maximum amount to be distributed should all possible class members be identified and file proofs of claim. On appeal, certain appellants raise the question of whether class members who file proper proofs of claim should be entitled to receive on a pro rata basis any portion of the damage award which remains unclaimed. Boeing, of course, contends that the unclaimed money should be returned to the corporation.

We see no reason to change our position, firmly stated in *Eisen* v. *Carlisle & Jaquelin*, 479 F.2d 1005 (2d Cir. 1973), *vacated and remanded on other grounds*, 417 U.S. 156, 94 S.Ct. 2140, 40 L.Ed.2d 732 (1974), disallowing a "fluid class" recovery such as sought by appellants. Although, in *Eisen*, the fund created by the unclaimed damages was to be used to benefit individuals who were arguably not members of the class, there is no difference in concept between the relief at issue in that case and the relief requested here, which in effect seeks distribution of the unclaimed portion to a "next-best" class. Moreover, there is even less to recommend appellants' proposal than the similar relief suggested in *Eisen*.[2]

The problems inherent in appellants' proposal are readily apparent.

> [T]his method expressly contemplates that silent class members will not receive any compensation, even

[2] In *Eisen* the class consisted of those who had bought or sold odd lots on the New York Stock Exchange in the period from May 1, 1962 through June 20, 1966. The undistributed funds were to be used, "for the benefit of all odd-lot traders by reducing the odd-lot differential 'in an amount determined reasonable by the court until such time as the fund is depleted' ". *Eisen* v. *Carlisle & Jaquelin*, *supra*, 479 F.2d at 1011.

> indirectly. The claims of the silent class members would be expropriated and a windfall might result for those who appeared and collected their share of the damages. Consequently, this procedure might encourage the bringing of class actions likely to result in large uncollected damage pools. It also raises serious questions as to the adequacy of representation where the interests of the named plaintiffs lie in keeping the other class members uninformed. In sum, the deficiencies of this method of distribution make it a generally unacceptable alternative. (Footnote omitted).

Note, *Damage Distribution in Class Actions: The Cy Pres Remedy,* 39 U.Chi.L.Rev. 448, 453 (1972). Appellants argue, however, that they should receive the unclaimed funds to defray the legal expenses of the claiming members of the class; in essence, that Boeing should pay, at least in part, their legal fees and disbursements. The simple answer to this argument is that, what appellants may not gain directly, *see Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U.S. 240, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975), they may not gain indirectly, and certainly not through such an imperfect vehicle as they have proposed. Without regard to the constitutionality of a "fluid class" award, *Eisen* v. *Carlisle & Jaquelin, supra,* 479 F.2d at 1018, the circumstances here simply do not call for this extraordinary remedy.

The case is remanded to the District Court for entry of a judgment in accordance with this opinion.

APPENDIX E

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 321-25—September Term, 1974.

(Argued February 26, 1975 Decided July 14, 1975.)

Docket Nos. 74-1157-59, -1165, -1185

WILLIAM R. VAN GEMERT, et al.,

Appellants,

—v.—

THE BOEING CO., et al.,

Appellees.

Before:

LUMBARD, OAKES and TIMBERS,

Circuit Judges.

Suit by holders of convertible debentures who failed to convert prior to company's redemption claiming insufficient notice of redemption provided. The United States District Court for the Southern District of New York, Sylvester J. Ryan, *Judge,* held that the notice provided by the company complied with the provisions in the debenture and underlying Trust Indenture; that the Trust Indenture Act of 1939 and the company's Listing Agreement with the New York Stock Exchange were not violated; and that appellants had no standing to raise a claim based upon an alleged failure to make a necessary adjustment in the

conversion rate. Held, that the appellants had stated a valid claim.

Judgment reversed.

STUART D. WECHSLER, KASS, GOODKIND, WECHSLER & GERSTEIN, New York, N.Y.; Sachnoff, Schrager, Jones & Weaver, Ltd., Chicago, Ill.; Elson, Lassers & Wolfe, Chicago, Ill., *for Appellants.*

NORMAN WINER, NATHAN, MANNHEIMER, ASCHE, WINER & FRIEDMAN, New York, N.Y., *for Appellants.*

S. HAZARD GILLESPIE, DAVIS POLK & WARDWELL, New York, N.Y. (David E. Wagoner, Perkins, Coie, Stone, Olsen & Williams, Seattle, Wash., William H. Levit, Jr., Hughes, Hubbard & Reed, Los Angeles, Cal., of counsel), *for Appellees.*

OAKES, *Circuit Judge:*

This appeal is from a judgment dismissing the amended complaint in a consolidation class action brought by non-converting holders of The Boeing Company's "4½% Convertible Subordinated Debentures, due July 1, 1980." The complaint was jurisdictionally based on the Securities Exchange Act of 1934 as amended, the Securities Act of 1933 as amended, the Trust Indenture Act of 1939 as amended and the principles of pendent jurisdiction.[1] The gist of the complaint was that the appellants and their class had inadequate and unreasonable notice of Boeing's intention to redeem or "call" the convertible debentures in question and were hence unable to exercise their conversion

1 *See* note 19 *infra.*

rights before the deadline in the call of midnight, March 29, 1966. Their damage lay in the fact that the redemption price for each $100 of principal amount of debentures was only $103.25, while under the conversion rate of, at a minimum, two shares of common stock for each $100 of principal amount of debentures, the stock was worth $316.25 on March 29, 1966, the cut-off date for the exercise of conversion privileges, or within 30 days thereafter, $364.00. The named appellants number 56, and the total loss alleged is over $2 million.

The United States District Court for the Southern District of New York, Sylvester J. Ryan, *Judge,* held that Boeing complied with the notice provisions spelled out in the debentures and in the Indenture of Trust Dated July 1, 1958 (the Indenture), between Boeing and The Chase Manhattan Bank (Chase), Trustee, and that it was required to do no more; that the Trust Indenture Act of 1939, 15 U.S.C. §§77aaa *et seq.*, was not violated; that if Boeing's Listing Agreement with the New York Stock Exchange (NYSE) were violated, it gave appellants no claim for relief; and that even if, as appellants claim, an adjustment in the conversion rate were required, and that failure to make the adjustment gave rise to a cause of action, appellants had no standing to raise the claim since they did not exercise their conversion rights. We reverse and remand on the ground that there was an obligation on Boeing's part to give reasonably adequate notice of the redemption to the debenture holders, which obligation was not fulfilled in this instance.

Most of the facts are not in dispute; indeed, we commend the parties, and the court below, for agreeing to a 59-page statement as to facts, incorporating some 55 exhibits, and to what certain witnesses would testify if called at trial.

THE ISSUE OF DEBENTURES

On July 15, 1958, each Boeing shareholder was given the right to purchase $100 of convertible debentures for each 23 shares of stock then held.[2] The debentures were to pay interest of 4½ per cent per annum and were to be convertible by the debenture-holder into common stock at a rate (subject to adjustment) of two shares per $100 principal amount of debentures. Chase was appointed trustee under the Indenture Agreement, and the debentures, as well as the stock reserved for issuance upon conversion of the debentures, were listed on the NYSE. Application for such listing had been made pursuant to a Listing Agreement between Boeing and the Exchange.

Subscriptions for a total of $29,578,500 of debentures were received[3] and the balance of $1,019,100 was purchased by the underwriters. Chase as trustee then authenticated and the subscription agent delivered by registered mail the entire $30,597,600 aggregate amount of debentures in coupon form to the persons designated in the warrants surrendered or their agents,[4] but no list of these was kept by Boeing or Chase.[5]

2 Total trading in the debenture rights was 1,702,200, but since no information is available on the number or retrades there is no way of knowing exactly how many rights were not traded. At the least, however, 5,335,248 rights were not traded on the Exchange.

3 One may estimate, from the number of rights not traded on the Exchange, approximately $21 million worth of the debentures were purchased by Boeing stockholders or their donees.

4 Between August 4, 1958, when the debentures were admitted to trading on the NYSE, and March 29, 1966, when conversion rights expired, a total of $68,694,000 face amount of debentures were traded. It is not known how many of the debentures were held by original subscribers at the later date.

5 City Bank-Farmers Trust Company, the subscription agent, retained through the ultimate date on which conversion rights expired the names and addresses of stockholders to whom the warrants were sent, as well as lists of the names and addresses of stockholders of record for the payment of dividends in May and August of 1958, and the warrants themselves when they were tendered. Although the list of stockholders was destroyed in 1964, the warants which bear the names and addresses of the original subscribers are presently in the possession of a successor agent.

A number of provisions in the debenture, the Indenture Agreement, the prospectus, the registration statement for the debentures and the Listing Agreement with the NYSE dealt with the possible redemption of the debentures by Boeing and the notice debenture-holders were to receive of a redemption call so that they might timely exercise their right to convert the debentures into common stock rather than have their debentures redeemed at face value. The debentures themselves provided:

> The holder of this Debenture is entitled, at his option, at any time on or before July 1, 1980, or in case this Debenture shall be called for redemption prior to such date, *up to and including but not after the tenth day prior to the redemption date, to convert this Debenture* . . . at the principal amount hereof, or such portion hereof, into shares of Capital Stock of the Company . . .
>
> . . . .
>
> The Debentures are *subject to redemption* as a whole or in part, at any time or times, at the option of the Company, *on not less than 30 nor more than 90 days' prior notice, as provided in the Indenture,* at the following redemption prices (expressed in percentages of the principal amount) . . .
>
> . . . .
>
> This Debenture may be registered as to principal upon presentation at the office or agency of the Company, in the Borough of Manhattan, The City of New York, New York, . . .

(Emphasis added.)

The Indenture itself, a 113-page printed booklet, provides in Art. V, § 5.02, as follows:

> In case the Company shall desire to exercise the right to redeem all or any part of the debentures, as the case may be, pursuant to Section 5.01, it shall publish prior to the date fixed for redemption a notice of such redemption at least twice in an Authorized Newspaper, the first such publication to be not less than 30 days and not more than 90 days before the date fixed for redemption. Such publication shall be in successive weeks but on any day of the week. . . .[6]

The Indenture also provided that debenture-holders who registered their bonds would receive notice by mail of any redemption call by the Boeing directors.

While the prospectus for the debenture issue did not refer to any registration rights, it did state that redemption could occur "on not less than 30 days' and not more than 90 days' published notice."

The NYSE Listing Agreement dated November 5, 1957, incorporated by reference into the listing application filed by Boeing in respect to the debenture issue, provided in Part III, Paragraph 4, as follows:

> 4. The Corporation will *publish immediately to the holders* of any of its securities listed on the Exchange *any action taken* by the Corporation *with respect* to dividends or to the allotment of rights to subscribe or *to any rights or benefits pertaining to the ownership of its securities listed on the Exchange;* and will give prompt notice to the Exchange of any such action; and *will afford the holders of its securities listed on the*

[6] An "Authorized Newspaper" is defined as one published at least five days a week and of general circulation in the borough of Manhattan, N.Y. *See* Indenture, Art. I, § 1.01.

> *Exchange a proper period within which* to record their interests and *to exercise their rights.* . . .

(Emphasis added.)

Section A10 of the NYSE "Company Manual" specifically defines what is meant by publicity in the Listing Agreement:

> Publicity: *The term "publicity,"* as used . . . below, and *as used in the listing agreement* in respect of redemption action, *refers to a general news release, and not to the formal notice or advertisement of redemption* sometimes required by provisions of an indenture or charter.
>
> *Such news release shall be made as soon as possible after corporate action which will lead to, or which looks toward, redemption* is taken . . . and shall be made by the fastest available means, i.e., telephone, telegraph or hand-delivery.
>
> To insure coverage which will adequately inform *the public,* the news should be released to at least *one or more newspapers of general circulation in New York City which regularly publish financial news,* or *to one or more of the national news-wire services* (Associated Press, United Press International), in addition to such other release as the company may elect to make.

Section A10 of the Company Manual also provides specifically that when a convertible security is to be redeemed, the news release must include the rate of conversion and the date and time when the conversion privilege expires. It further provides that in addition to the immediate news release the company must give notice immediately to the NYSE itself, so as to enable the NYSE to take any necessary action with respect to further trading in the security.

THE CALL AND ITS CIRCUMSTANCES—HEREIN OF THE NOTICE ACTUALLY GIVEN

On February 28, 1966, the Boeing board of directors *inter alia* authorized the president, vice president-finance or treasurer to call for redemption on a date to be selected by them or any one of them, all of the convertible debentures outstanding under the indenture of July 1, 1958. That same day a news release, headlining 1965 sales and net earnings, and referring to a contemplated stock increase, stock split and post-split dividends, mentioned that "[t]he company's management was also authorized to call for redemption at a future date all of company's outstanding 4½ percent convertible subordinated debentures." This statement, which did not mention even the tentative dates for redemption and expiration of the conversion rights of debenture holders that had been settled upon, was released by the Boeing "News Bureau" nationally to the financial editors of the New York Times, the New York Herald-Tribune, the Wall Street Journal and other major national newspapers, in addition to the major wire services (Associated Press, United Press International and Dow Jones & Co.).

A short time after the February 28 board meeting, Boeing firmed up the key dates, complied with the indenture notice requirements and communicated to some extent with the Exchange proper. On March 2, 1966, at the home office in Seattle, at a meeting of Boeing officers, bankers and lawyers, it was decided to fix March 8 as the date for the first publication of the formal notice of redemption, April 8 as the redemption date and March 29 as the date for expiration of the conversion privilege. The second date for publication of the formal notice, March 18, was also fixed upon at this March 2 meeting, and Chase was notified to publish the redemption notice on those dates in all editions of the Wall Street Journal. All editions of the Journal carried the formal notices on March 8 and 18; the notices were in due form if not of extensive size.[7] It is conceded by the appellants that the formal requirements of the Indenture were met by the Company and Trustee.

It was not until March 7, the day before the publication of the first formal notice of redemption, that the NYSE was itself notified of the firmed-up dates for redemption,[8] conversion and notice. This was done by a telephone call from Company counsel in Seattle to the Exchange. While the court below found in part that "Boeing did comply with the publicity requirements of the Exchange" and while Company counsel "felt" on the basis of his telephone call "that we had complied with the recommended procedures [of the Stock Exchange Manual]," this finding and feeling are in the face of Boeing's response *admitting* appellants' demand for admission

> That Boeing did not issue any general publicity release, as that term is defined in Section A-10 of the New York Stock Exchange Company manual, concerning the call of the debentures during the period from March 1, through March 24, 1966.

This admission was reconfirmed by counsel for Boeing below and on appeal in the course of an "opening" statement to the court. The original news release of February 28 did not qualify since the dates of conversion and redemption had not been fixed and the Manual requires in the case of convertible securities that the publicity set forth "the rate of conversion and the date and time when the conversion privilege will finally expire" and that if

---

7 We estimate their size as 5" x 5½".

8 The Exchange had been sent a communication concerning the redemption on March 1, 1966, but at that time no redemption date had been established.

such data are not known at the time publicity is given initially, "similar publicity shall be given immediately it becomes known or determined." The formal notices did not qualify since the Manual refers to a "general news release," and not to the formal notice or advertisement of redemption. In this regard it is interesting to note that a letter dated March 9 from the stock list department of the Exchange to Boeing indicates that "We have noted the recent advertisement advising of the call for redemption" and also asks for a copy of the authorizing resolution.

There was, in short, no general news release as called for by the Listing Agreement as amplified in the Company Manual until on the eve of expiration of the conversion rights, March 25, 1966, it appeared that $10,849,300 face amount of debentures—over one-half of those outstanding at that time—remained unconverted. At that point Boeing issued a press release[9] and then on March

9 DEBENTURE CONVERSION DATE MARCH 29

Final date for conversion of The Boeing Company's 4½ per cent convertible subordinated debentures to Boeing common stock is Tuesday, March 29, as announced in advertising by the company on March 8, 9 and 10.

The conversion rights provide for issuance of two shares of common stock in the company for each $100 bond. The company's notice of redemption announced that all outstanding debentures would be redeemed on or after April 8 at the redemption price of 103.25 per cent of their principal amount, together with accrued interest to that date.

Closing price of the stock as of March 25 was $154.5, representing a substantial advantage to holders of the bonds if the conversion is elected.

From January 1, 1965 through March 25, 1966, the sales price for the common stock of The Boeing Company ranged from a high of $175.25 to a low of $60.375 per share. As was pointed out in the notice of redemption, so long as the market price of the common stock is $52.24 or more per share, a debenture holder would receive upon conversion before the March 29 deadline, common stock having a greater value than the cash he would receive if he surrendered the debenture for redemption.

28 the Company republished its earlier advertisement in all editions of the Wall Street Journal (Eastern, Mid-Western, Pacific Coast and South-West) and the New York Times, and additionally advertisements were placed. This later action had what the court below termed a "dramatic and widespread rippling effect." Some $9,305,000 of debentures were converted on March 28 and 29. The ripples, however, had not spread to the appellants' class by the midnight deadline on the 29th; they literally went to sleep with $1.5 million of debentures that were worth $4 million if only converted.

It is true, however, and the court did properly find, that in addition to the publication of the two formal indenture notices, notices of the dates of the call and the expiration of the conversion privilege on March 29, 1966, were carried on the following services: NYSE ticker on March 8, 23, 24, 25, 26 and 28, 1966; NYSE Bulletin on March 11, 18 and 25, 1966; The Commercial and Financial Chronicle on March 14, 21 and 28, 1966; Standard & Poor's Bond Outlook on March 19, 1966; Standard & Poor's Called Bond Record on March 9, 11, 18 and 25, 1966; Moody's Industrials on March 11, 1966. Articles about these dates were also carried in the Seattle Post Intelligencer on March 25, 1966; the Seattle Times on March 27, 1966; and the Financial World on March 23, 1966; and the notice was also carried in the Associated Press Bond Tables published on one or more days in at least 30 newspapers published in major cities across the United States. But almost all of these notices or items were in fine print, buried in the multitude of information and data published about the financial markets and scarcely of a kind to attract the eye of the average lay investor or debenture holder. On March 9, 1966, the listing in the New York Times for the convertible debentures read, for example: "Boeing cv 4½ s 80." The change

on March 10 was to "Boeing 4½ s 80 cld," giving the investor in Dubuque or Little Rock or Lampasas only 19 days to pick up this change and figure that "cld" meant "called." Proof of the inadequacy of these notices lies in the fact that, despite the dramatic disparity between the value of the debentures unconverted and the conversion stock, over one-half of the debentures outstanding on the date of the first notice remained unconverted until the general publicity release on the eve of expiration of the conversion privilege.[10]

Because the appellants place some emphasis on the fact, although we do not reach their contention of unreasonable notice based on it, we should mention that Boeing made no attempt to mail notice to the original subscribers (which could have been done at concededly nominal expense), and neither Boeing nor Chase inquired of or gave notice to collecting banks which had tendered for collection coupons bearing the payment dates of July 15, 1965, or January 15, 1966, the last two coupons before the redemption, either of which might have had some beneficial effect.[11]

THE CONTENTIONS OF THE PARTIES

Boeing rests its defense primarily upon the notice specified in the debentures and Indenture, pointing out that in 1958 when the debentures were issued, "the risk that actual notice might not be received by subsequent holders of the debentures was clearly accepted by all even re-

10 On March 8, 1966, $21,514,700 face amount of debentures were still outstanding. On March 25, 1966, as stated, four days before the expiration of the conversion privilege, over one-half of these $10,849,300, had not been converted.

11 Nor do we reach the legal argument under the Trust Indenture Act, 15 U.S.C. § 77bbb, based upon the Indenture's provisions requiring Boeing to give Chase lists of the names and addresses of debenture holders obtained by the former, and the token compliance therewith.

motely familiar with the nature of such debentures." (Brief at 20-21.) It was "just such a risk" that led Boeing to extend to its stockholders and others who were investing $30 million in these securities the opportunity to register, *see Kaplan* v. *Vornado, Inc.*, 341 F. Supp. 212, 216 (N.D. Ill. 1971), an opportunity availed of by only 7 per cent of the debenture holders.[12] For the proposition that notice by publication provided for here was "standard and conformed with the custom and practice prevailing in the trade in 1958," we are referred by Boeing to *Gampel* v. *Burlington Industries, Inc.*, 43 Misc. 2d 820, 252 N.Y.S.2d 500 (Sup. Ct. 1964), where Justice Korn did not discuss the custom and practice in the trade but did hold that publication in the Wall Street Journal even during a newspaper delivery strike conformed to a provision in the Burlington Industries debentures similar to the one in the case at bar.[13]

There are four main strings to the appellants' bow. The first is that Boeing is civilly liable under federal law for violation of the NYSE Listing Agreement and Section A10 of the NYSE Company Manual since their requirements are an extension of the Securities Exchange Act of 1934 and an integral part of the statutory scheme under which exchanges are required to adopt rules, 15 U.S.C. § 78f, which may be ordered by the Commission to be altered, 15 U.S.C. § 78s, and the violation of which may give rise to a civil action under federal law. *Cf. Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969). The second

12 Through April 8, 1966, $1,838,000 in face amount of the debentures were registered as to principal and interest and $337,700 as to principal only; thus, approximately 7 per cent of the debentures were in fact registered so that their holders thereby automatically received notice from the trustee.

13 *See generally* Miller, *How to Call Your Convertibles*, Har. Bus. Rev. 66 (May/June 1971).

is that appellants are third party beneficiaries under state law of the Boeing-NYSE Listing Agreement, as amplified by the Company Manual. *Lawrence* v. *Fox,* 20 N.Y. 268 (1859). *See Weinberger* v. *New York Stock Exchange,* 335 F. Supp. 139 (S.D.N.Y. 1971) (Gurfein, *J.*) (Exchange liable under agreement with SEC to limited partner of bankrupt member firm inadequately supervised by Exchange). The third claim of appellants is that the Indenture is in the nature of a contract of adhesion, a standardized contract between parties of disparate bargaining power, unconscionable features of which are unenforceable as a matter of policy, a concept perhaps first advanced as to indentures of trust covering convertible debentures in a student note, *Convertible Securities: Holder Who Fails to Convert Before Expiration of the Conversion Period,* 54 Cornell L. Rev. 271 (1969). *Cf. Gray* v. *Zurich Insurance Co.,* 65 Cal.2d 263, 269, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966). *See* Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract,* 43 Colum. L. Rev. 629 (1943). The fourth ground is that the call was illegal and therefore void because it was based upon a conversion rate of 2.00 shares per $100 face amount of debentures when as a result of two stock dividends and an acquisition it should have been on a 2.05 or a 2.08 ratio.

THE FEDERAL LAW CLAIM

The claim that Boeing is civilly liable under federal law for violation of the NYSE Listing Agreement and Section A10 of the Company Manual is a colorable one. The Listing Agreement and Company Manual are "instruments corresponding" to rules of the Exchange within Section 6(a)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78f(a)(3). For the debentures here in question to be listed on the Exchange, application under the Listing

Agreement had to be made. Boeing did not comply with the publicity requirements of the Exchange. In *O'Neill* v. *Maytag,* 339 F.2d 764, 770 (2d Cir. 1964), we did say, however, in the context of a stockholder's derivative suit arising out of an air carrier's purchase of its own stock, that a transaction which violated an Exchange rule did not give rise to a cause of action under federal law, at least against a listed company or its officers.

But as the Supreme Court held in *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), private parties have both derivative and direct rights of action to bring suit for violations of the Securities Exchange Act of 1934 and SEC rules and regulations issued thereunder, rights the explication of which take up a fair amount of Second Circuit judicial time. We extended this at least by dictum to include violation of stock exchange and securities dealers' association rules designed for the direct protection of investors, at least in a suit against an Exchange member, in *Colonial Realty Corp.* v. *Bache & Co.,* 358 F.2d 178 (2d Cir.), *cert. denied,* 385 U.S. 817 (1966). There, Judge Friendly, speaking for a unanimous court, pointed out that "the concept of supervised self-regulation is broad enough to encompass a rule which provides what amounts to a substitute for a regulation by the SEC itself." 358 F.2d at 182. Again, "[a] particular stock exchange rule could thus play an integral part in SEC regulation notwithstanding the Commission's decision to take a back-seat role in its promulgation and enforcement . . . ," *id.,* giving as an example NYSE Rule 452 which prohibits a member from voting stock held in a street name without specific instructions from the beneficial owner. *Id.* at n.4. Judge Friendly then went on to say that

> what emerges is that whether the courts are to imply federal civil liability for violation of exchange or dealer association rules by a member cannot be deter-

> mined on the simplistic all-or-nothing basis urged by the two parties; rather, the court must look to the nature of the particular rule and its place in the regulatory scheme, with the party urging the implication of a federal liability carrying a considerably heavier burden of persuasion than when the violation is of the statute or an SEC regulation. The case for implication would be strongest when the rule imposes an explicit duty unknown to the common law.

Id.[14] *See* Lowenfels, *Liability under Exchange Rules*, 2 Rev. of Securities Regulation 841 (1969). *See also Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc., supra* (upholding implied private right based upon the so-called "Know Your Customer" rule, which is Rule 405 of the NYSE, against a party not a stock exchange member).

Nevertheless, we do not now take the position that appellees advance and the court below apparently accepted, that violation of an exchange rule cannot under any circumstances give rise to civil liability under the federal acts. Such a position would be in conflict with our own most recent statements on this subject as well as some of the developing case law. *See, e.g.*, Judge Weinfeld's opinion in *Starkman* v. *Seroussi*, CCH Fed. Sec. L. Rep. ¶ 94,600 [1973-74 transfer binder] (S.D.N.Y. 1974) (con-

14 The court went on to hold, however, that the rules at issue in *Colonial Realty Corp.* v. *Bache & Co.*, 358 F.2d 178 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966), were "near the opposite pole," that is to say, they were "something of a catchall" which related to unethical behavior as well as illegal conduct. It is to be noted that *Colonial Realty* was not the first Second Circuit case dealing with stock exchange rules. In *Baird* v. *Franklin*, 141 F.2d 238 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944), the court recognized that culpable failure by a stock exchange to enforce rules adopted pursuant to § 6(b) of the Securities Exchange Act might give rise to a federal claim against the *exchange* by an investor injured thereby. *See also Silver* v. *NYSE*, 302 F.2d 714, 719 (2d Cir. 1962), *rev'd on other grounds*, 373 U.S. 341 (1963).

duct in violation of Rule 345.17 of the Exchange prohibiting registered representatives from guaranteeing any customer against loss in his account or receiving a share in the profits or sharing in the losses of a customer's account, held actionable); *SEC* v. *First Securities Co. of Chicago*, 463 F.2d 981 (7th Cir.), *cert. denied*, 409 U.S. 880 (1972) (violation of NASD rule protecting public gives rise to private damage action). *Cf. Landy* v. *Federal Deposit Insurance Corp.*, 486 F.2d 139, 164-66 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

It would also run contrary to a position we find inviting, that to the American investing public listing on the New York Stock Exchange carries with it implicit guarantees of trustworthiness. The public generally understands that a company must meet certain qualifications of financial stability, prestige, and fair disclosure, in order to be accepted for that listing, which is in turn so helpful to the sale of the company's securities. Similarly it is held out to the investing public that by dealing in securities listed on the New York Stock Exchange the investor will be dealt with fairly and pursuant to law. This would be particularly true as to the convertible securities market which differs from the market for other corporate debt in that it is composed primiraly of individuals. *See* 1A Dewing, The Financial Policy of Corporations 268-71 (5th ed. 1953).[15] Some investors miss the notices of redemption

15 The aggregate amount of convertible bonds outstanding of companies listed on the New York Stock Exchange in March of 1963, according to Standard & Poor's Earnings and Rating Bond Guide, was $2,300,000,000, of those listed on the American Stock Exchange $92,000,000, and of unlisted companies $880,000,000. *See* 2 Report of Special Study of Securities Markets made pursuant to Section 19(d) of Securities Exchange Act of 1934 at 23. The Commission is well aware that individual shareholders to whom rights to subscribe to debentures are distributed by the corporations have no control over the time of distribution or whether there should be a distribution. Hence they are "participating in the market involuntarily, so to speak . . . ." *Id.* at 24.

and of expiration of conversion rights, while others "do not know that they should look for them." Note, 54 Cornell L. Rev. at 274 n.16.[16]

Appellees argue, however, that the self-regulation system of the 1934 Act applies in its terms only to Exchange *members*, as opposed to *issuers*, and that the legislative history indicated congressional intention not to extend coverage of the Exchange rules and regulations to issuers. In this connection appellees maintain that Congress did consider such an extension as evidenced by a proposed § 12(b)(1) to the Securities Exchange Act quoted in Cong. Rec. 8584 (1934), which was never adopted. *Id.* at 8586. The provision, however, was to require listed companies to agree with the Exchange to comply with the Exchange Act and the Commission's rules and regulations, and much of the debate related to whether the provision was necessary at all since such companies would have to comply with the law regardless of any such agreement.[17] Omitting the section

16 Cases involving generally broad standards of conduct and having nothing to do with disclosure, *see, e.g., Hecht* v. *Harris, Upham & Co.*, 283 F. Supp. 417 (N.D. Cal. 1968), *modified on other grounds*, 430 F.2d 1202 (9th Cir. 1970), require the presence of fraud to create a right of action under federal law, but this is because the only action or conduct proscribed by the rule is fraudulent conduct. Here, however, is involved a notice or notification rule.

17 Senator Hastings made the following statement in connection with the legislation:

> I do not quite understand why they want to get the issuer of the security on record, in the form of an agreement, not to violate a particular law, because it must be admitted that, if the law itself is valid, and if the rules and regulations made by the commission are valid, and the person entering into the agreement has brought himself within the law by offering his securities for sale, then certainly, it seems to me, the point of compelling him to sign a paper that he will abide by the laws and rules made by the commission must have back of it something which those of us who studied the bill do not quite understand.

78 Cong. Rec. at 8585 (1934). While Senator Hastings' amendment was defeated, the language he objected to was deleted in conference.

in question would apparently indicate merely a recognition that the provision was unnecessary. The legislative history is thus at most equivocal on the question whether Congress intended to insulate issuers from liability in the event that they violated an Exchange rule.[18]

Appellees argue also that the Exchange's remedies are limited to delisting. *See* Report of Special Study of Security Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess., Pt. IV, ch. XII at 566-67; *Intercontinental Industries, Inc.* v. *American Stock Exchange*, 452 F.2d 935 (5th Cir. 1971), *cert. denied*, 409 U.S. 842 (1972) (permitting delisting). But no authority holds that the exclusive remedy against a listed company is delisting. The claim for relief is sufficient for jurisdictional purposes in any event.[19]

18 Provisions of the Listing Agreement requiring the corporation to, *e.g.*, "promptly notify the Exchange of any changes of officers or directors," Part I, 2, would not seem to give rise in any event to a liability to a securities holder. The provisions of the Listing Agreement here in question, however, were to "afford the holders of its securities listed on the Exchange a proper period within which . . . to exercise their rights . . . ."

19 *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 724 (1966). *See Hudak* v. *Economic Research Analysts, Inc.*, 499 F.2d 996, 1001 (5th Cir. 1974); *Parrent* v. *Midwest Rug Mills, Inc.*, 455 F.2d 123, 129 (7th Cir. 1972). The writer of the opinion for himself alone would hold that even if there were such a duty it would be essentially coterminus with a contractual duty to the appellants as third party beneficiaries. As he views it, the limited notification provisions of the Indenture and debenture were modified by virtue of the application for listing on the stock exchange, which specifically incorporated by reference the Listing Agreement of November 5, 1957, to which we have so frequently alluded. *See Lawrence* v. *Fox*, 20 N.Y. 268 (1859); *Seaver* v. *Ransom*, 224 N.Y. 233, 120 N.E. 639 (1918); *Weinberger* v. *NYSE*, 335 F. Supp. 139 (S.D.N.Y. 1971). The duty of a listed company to its own securities holders to treat them fairly is founded in fundamental concepts of the law pertaining to corporate fiduciaries. *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949); *Pepper* v. *Litton*, 308 U.S. 295 (1939); *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973). Security holders of a

THE INADEQUACY OF THE BOEING NOTICE

The notice Boeing gave, we hold, had two deficiencies. First, Boeing did not adequately apprise the debenture holders what notice would be given of a redemption call. Investors were not informed by the prospectus or by the debentures that they could receive mail notice by registering their debentures, and that otherwise they would have to rely primarily on finding one of the scheduled advertisements in the newspaper or on keeping a constant eye on the bond tables. Second, the newspaper notice given by Boeing was itself inadequate.

The first factor we think highly significant. Many of the debenture holders might well have decided to register their bonds, had the significance of registration, or of the failure to register, been brought home in the materials generally available to the purchasers of the debentures. No detailed information as to notice was given on the face of the debentures, even in the fine print. The debentures stated simply:

> The debentures are subject to redemption, as a whole or in part, at any time or times, at the option of the Company, in not less than 30 nor more than 90 days' prior notice, as provided in the Indenture . . .

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corporation are in a very real sense creditor beneficiaries, *see* 1 Restatement of Contracts § 136 (1932), to whom an underlying duty of fair treatment is owed by the corporation or majority stockholders or controlling directors and officers thereof. While it may be said that the Indenture itself is a contract, *Kaplan* v. *Vornado, Inc.*, 341 F. Supp. 212 (N.D. Ill. 1971); *Buchman* v. *American Foam Rubber Corp.*, 250 F. Supp. 60 (S.D.N.Y. 1965), it was clearly entered into with listing on the NYSE in mind and was substantially simultaneous in execution and coordinate in operation with the listing application. On this basis it would be unnecessary in the writer's view to reach the ground upon which the court relies, but since this view is individual only, he joins in the ground for decision taken.

There was no indication that registration would mean that a debenture holder would receive mail notice. Nor was there any indication of the extent of newspaper notice to be provided—either as to the papers that would be used or how often the notice would be published. Debenture holders were simply referred by the debenture, as well as by the prospectus, to the 113-page Indenture Agreement, which, to be sure, was available to debenture holders or prospective purchasers upon request, but which was not circulated generally with the warrants or debentures.

We have dwelt at length in the facts on the newspaper notice actually given. While it may have conformed to the requirements of the Indenture it was simply insufficient to give fair and reasonable notice to the debenture holders.

The duty of reasonable notice arises out of the co. 'ract between Boeing and the debenture holders, pursuant to which Boeing was exercising its right to redeem the debentures. An issuer of debentures has a duty to give adequate notice either on the face of the debentures, *Abramson* v. *Burroughs Corp.*, CCH Fed. Sec. L. Rep. [1971-72 transfer binder] ¶ 93,456 (S.D.N.Y. 1972) (Lumbard, *C.J.*, sitting by designation), or in some other way, of the notice to be provided in the event the company decides to redeem the debentures. Absent such advice as to the specific notice agreed upon by the issuer and the trustee for the debenture holders, the debenture holders' reasonable expectations as to notice should be protected.

For less sophisticated investors (it will be recalled that warrants for the purchase of debentures were issued to *all* Boeing shareholders), putting the notice provisions only in the 113-page Indenture Agreement was effectively no notice at all. It was not reasonable for Boeing to expect these investors to send off for, and then to read under-

standingly, the 113-page Indenture Agreement referred to in both the prospectus and the debentures themselves in order to find out what notice would be provided in the event of redemption.

Boeing could very easily have run more than two advertisements in a single paper prior to the eleventh hour (March 28), at which time it issued its belated news release and advertised for the third time in the Wall Street Journal and for the first time in the New York Times. Moreover, in the same period that the debentures were in the process of being redeemed, Boeing was preparing for its annual meeting (to be held April 24). Proxy materials were being prepared throughout March and were finally mailed sometime between March 24 and March 30. Management could readily have arranged the redemption dates and the proxy mailing so that notice of the redemption dates could have been included in the envelope with the proxy materials. Thus at no extra cost except that of printing brief notices, at least all Boeing shareholders would have received mail notice, and presumably a significant number of the plaintiff class owned Boeing common stock, as well as debentures, in 1966. Had Boeing attempted such mail notice, or mail notice to original subscribers, and also given further newspaper publicity either by appropriate news releases or advertising earlier in the redemption period, we would have a different case and reasonable and sufficient notice might well be found.

Nothing that we have said is inconsistent with either *Abramson* v. *Burroughs Corp., supra,* or with *Kaplan* v. *Vornado, Inc., supra.* These cases are distinguishable on their facts as well as in respect to the legal arguments made.

In *Abramson* the court was presented with the claim that Rule 10b-5 was violated in connection with the sale

of certain convertible debentures. As here, a nonconverting debenture holder was suing for the amounts lost when he failed to convert before the expiration of the conversion period and he challenged the notice procedures in connection with the redemption. In *Abramson,* however, the principal contention was that there were material omissions in the *prospectus* issued in connection with the sale of the debentures. Abramson alleged that the notice provisions in the prospectus were misleading in that they omitted the nature and frequency of notice that bondholders would receive.

Judge Lumbard in *Abramson* found quite to the contrary that the face of the debentures—unlike those here—stated exactly what notice would be provided, notice which incidentally was at least twice that required here, making specific reference to publication once a week for four weeks in a newspaper of general circulation in New York and one in Detroit. Thus the Burroughs debentures in *Abramson* specifically informed the investor where and how often notice of redemption would be published so that he could make a reasonable evaluation of the likelihood that he would receive such notice or take steps to increase the chances that he would see it either by subscribing to the Wall Street Journal or the like, by contacting a broker to handle the matter for him, or by registration.[20]

The notice provisions in *Abramson* were minimal but sufficient to clear judicial approval; the notice here was

20 In *Abramson,* moreover, the court emphasized that the debentures in issue specifically stated on their face that the bonds could be registered, and if registered that notice of a call would be provided to registered holders by mail. The court therefore concluded that the nonconverting debenture holders had themselves to blame for not receiving notice. Here, there was no such explicit information on the Boeing debentures. While the debentures did state that they could be registered, as we have said, there was no indication that registration would protect the investor by providing him with notice by mail.

significantly less. Moreover, the Boeing debentures themselves were somewhat misleading. While they indicated that redemption could be made on not less than 30 days' notice, one would have had to have been, if not a lawyer, at least an experienced and knowledgeable investor, to read the fine print two paragraphs previously which said that the conversion right ran only "to and including but not after the tenth day prior to the redemption date . . . ."

In *Kaplan* v. *Vornado, Inc., supra,* where the percentage of nonredeeming debenture holders was under 3 per cent as opposed to the 7 per cent here, in addition to notices published in the New York Times in accordance with the indenture agreement there was a press release *prior* thereto which resulted in publications of the announcement of redemption in the Wall Street Journal, Women's Wear Daily, Daily News Record, Homes Furnishing Daily, and on the Reuters and Dow-Jones wire services. The court in *Kaplan* specifically found that "the essential facts of the defendant's redemption and of the termination of the holders' conversion rights were printed in these news items." 341 F. Supp. at 213.[21]

What one buys when purchasing a convertible debenture in addition to the debt obligation of the company incurred thereby is principally the expectation that the stock will increase sufficiently in value that the conversion right will make the debenture worth more than the debt. The debenture holder relies on the opportunity to make a proper conversion on due notice. Any loss occurring to him from failure to convert, as here, is not from a risk inherent in his investment but rather from unsatisfactory notification procedures. *See* Note, 54 Cornell L. Rev. at

21 The writer would note that in *Kaplan* the company did indeed comply with the NYSE Listing Agreement-Company Manual requirement of a general news release at the start of the redemption.

271. *See also* Miller, *How to Call Your Convertibles,* Harv. Bus. Rev. 66, May/June 1971.[22] The debenture holder's expectancy is that he will receive reasonable notice and it is his reliance on this expectancy that the courts will protect. *See generally* Fuller & Perdue, *The Reliance Interest in Contract Damages,* 46 Yale L.J. 52, 373 (1936-37). *See, e.g., Associated Perfumers, Inc.* v. *Andelman,* 316 Mass. 176, 55 N.E.2d 209 (1944). *See also Schlick* v. *Penn-Dixie Cement Corp.,* 507 F.2d 374 (2d Cir. 1974), *cert. denied,* 43 U.S.L.W. 3611 (U.S. May 19, 1975). Had there been proper publication, a reasonable investor undoubtedly would have taken action to prevent the loss occurring to him.

Of course, it may be suggested that the appellee corporation itself was not the beneficiary of the appellants' loss; rather, the corporate stockholders benefited by not having their stock watered down by the number of shares necessary to convert appellants' debentures. But an award against Boeing will in effect tend to reduce *pro tanto* the equity of shareholders in the corporation and thus to a large extent those who were benefited, one might almost say unjustly enriched, will be the ones who pay appellants' loss.[23]

22 Obviously, where a conversion is not made there may be costs to the company itself which unnecessarily has to make redemption payouts. Miller, Harv. Bus. Rev. at 67. Miller goes on to say that "newspapers have *not* proved an effective conduit, and because of this the corporate officer must concentrate on the mailing approach." Perhaps one solution to the overall problem would be the English one, whereby the convertible debenture is considered converted once the total principal amount of the issue outstanding is less than 25 per cent of its original size. *Id.* at 70.

23 On the remand for a determination of damages, it might be appropriate for the district court to allow Boeing to meet the liability resulting from this case by issuing stock. That is what the plaintiffs would have had if they had received notice of the redemption call, and one of the purposes of the redemption was to enable the company

On the foregoing basis it is unnecessary for us to determine whether there is any cause of action under the Trust Indenture Act, 15 U.S.C. § 77bbb, as appellants contend. Nor, because appellants would not have standing to assert it, do we ground liability upon or make reference in the context of liability to appellants' argument that the call was illegal in the first instance because it was based upon an improper conversion rate.

DAMAGES AND THE "CONVERSION RATE"

We must, however, in remanding to the district court for a determination of damages, take note of the conversion rate argument which was rejected by the court below. That argument was essentially that the 4 per cent stock dividend declared in November, 1958, the 2 per cent stock dividend declared in November, 1959, and the acquisition by Boeing on March 31, 1960, of substantially all the assets of Vertol Aircraft Corp. necessitated an adjustment in the conversion rate of two shares of Boeing stock for each $100 of debentures in accordance with Section 4.05 of the Indenture.[24] At all times after these three transactions, Boeing treated the conversion rate as 2.0448. Because that rate was under 2.045, no adjustment was required under the Indenture § 4.05(f), which provided in part that

> Whenever the amount by which the conversion rate would be changed in accordance with the foregoing provisions of this Section 4.05 is less than one-twentieth of a share of Capital Stock the Company at its option need not make such adjustment at that time.

to exchange debt for equity capital. It would thus seem appropriate for Boeing to be able to issue stock to meet all or part of this liability, with, of course, the shares being valued according to their market value at date of issuance.

24 The section is four printed pages long and therefore will not be reprinted here in its entirety.

Appellants on the other hand contend that the proper conversion rate was at least 2.045 or as high as 2.08.

On November 4, 1958, Boeing declared a 4 per cent stock dividend and issued 281,537 shares therefor. Section 4.05(b)iv states that in the case of shares so issued the consideration therefor shall be "deemed to be the number of shares so issued multiplied by the market value thereof."[25] Boeing initially calculated the market value by including the stock dividend shares in the number of shares outstanding to obtain the market value of the post dividend stock, *i.e.*, by dividing the closing price of the stock on November 4 of $56.875 by 1.04 since there were 104 shares where there had been 100. This resulted in a market value figure rounded off to $54.75 which, multiplied by the number of stock dividend shares issued, gave a total consideration therefor of $15,414,151.[26] On this basis the calculated rate was 1.9927 but since the indenture required that the conversion rate not be below 2.00, note

25 Market value in connection with a limited stock dividend is defined in Section 1.01 as follows:

> For the purposes of this definition market value shall mean the last reported sale price of the Capital Stock of the New York Stock Exchange (or if not listed on the New York Stock Exchange, then on any national securities exchange where listed) on the date of declaration of each stock dividend involved or, if there shall not have been a sale on such date, on the basis of the average of the bid and asked quotations therefor on said exchange on such date, or if the Capital Stock shall not then be listed on any national securities exchange, on the basis of the average of the bid and asked quotations in the over-the-counter market on such date.

26 That consideration and the number of shares issued were to be added to the initial consideration of $351,872,350 and 7,037,447 (valued at $50 per share) shares. Under the basic conversion rate formula the product of $100 and the number of resulting shares is divided by the aggregate consideration. "The resulting quotient, adjusted to the nearest one-hundredth, shall thereafter be the conversion rate (until further adjusted) if it is greater than the basic conversion rate [of 2.00 shares for each $100 debenture]." Sec. 4.05(a). But if the adjusted rate is *less* than 2.00 the basic conversion rate of 2.00 governs.

26 *supra*, the rate remained at 2.00. Appellants agree that the rate should be 2.00 but contend that the consideration for the stock dividend shares should be treated as at $14,076,850, the figure which would result from a flat 2.00 or $50 per share rate (above which stock dividend shares could not be valued under the limitations of Section 4.05(a), note 26 *supra*).

Initially the 2 per cent stock dividend of 147,489 shares on November 2, 1959, was treated by Boeing in the same way as the previous year's dividend. The November 2, 1959, closing price of $30.375 per share was divided by 1.02 to obtain a quotient of $29.77 which, multiplied by the number of shares (147,489), gave additional consideration of $4,390,748 to be added to the aggregate consideration (under Section 4.05(b))[27] after the prior stock dividend.

The gist of appellants' complaint about the conversion rate is that in connection with the acquisition of Vertol Aircraft assets in 1960 for 472,736 shares of Boeing, not only were the Vertol assets overevaluated and evaluated at the wrong time so as to obtain the highest evaluation, but the prior stock dividend adjustments were recomputed to the debenture holders' disadvantage. The argument is that all this was done having the conversion rate precisely in mind and with the purpose of keeping it at 2.044999 or below so as to avoid adjustment. (See Exhibit 28.)

The recomputation of the stock dividend adjustments was as follows. The full share price of $56.875 at the close of the 1958 dividend day was taken, that is, the stock dividend shares were not included in the number of shares outstanding. Thus the consideration received was calculated at $16,012,417 (281,537 x 56.875) rather than

27 Appellants overlook the aggregate aspect of Section 4.05(b).

the $15,414,151 previously used. The same was done in connection with the 1959 2 per cent stock dividend, resulting in increased consideration of $4,479,979 rather than the $4,390,748 previously used. Appellants urge that Boeing thereby "added" consideration received of $1,935,-567 from the 1958 dividend (because appellants would treat that as $14,075,850) and $87,843 from the 1959 dividend, thus leaving at the end of this recomputation a conversion rate of 2.0052 rather than one of 2.0161. But the lower court found, and we agree, that while appellants' computations, or at least Boeing's original ones, better represent the economic realities and more accurately follow general accounting practice, there was discretion in the Board under Section 1.01, note 25 *supra*, not to include the dividend shares in computing the market value.

In connection with the Vertol acquisition, the value placed on it for purposes of determination of the conversion rate was the market value of the Boeing stock on November 13, 1959, at 33⅝, for a total of $15,895,748. Appellants argue that three different valuations would have been more accurate and fairer: the valuation on March 31, 1960, of the Vertol assets as recorded on the Boeing books at $12,435,138.47; that on January 18, 1960, when the contract of acquisition was signed and the Boeing stock worth 30⅝; or that on March 30, 1960, when the contract was closed and the Boeing stock worth 24⅛. Any one of these valuation measures would have increased the conversion ratio to over 2.045. But Section 4.05(b)(2) of the Indenture provided that "in the case of the issuance of shares for consideration in whole or in part other than cash, the consideration other than cash shall be deemed to be the fair value thereof as determined by the board of directors." The district court's finding was that there was no evidence that Boeing "had any purpose of delib-

erately hurting its debenture holders" and that while it was true that on November 13, 1959, the acquisition was still tentative, the board of directors had a colorable right to fix the fair value of the consideration as of November 13, 1959. That decision was one made, the court below found, in good faith and with the approval of accountants, auditors, investment bankers and counsel. Consequently, the court found that the decision was not subject to attack. *See Morris* v. *Standard Gas & Electric Co.*, 31 Del. Ch. 20, 63 A.2d 577 (1949). We do not believe the trial court's findings clearly erroneous. On those findings the conclusion of law was correct. In short, we affirm so much of the trial court's opinion as relates to the conversion rate.

Judgment affirmed in part; reversed and remanded in part.